TAX ★★★97

1997 Tax Legislation

Law, Explanation and Analysis

Taxpayer Relief
Act of 1997

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Key Figures from 1997 Tax Act

EDUCATION INCENTIVES

2-year HOPE credit after 1997, up to the greater of: 100% of $1,000 tuition/fees and 50% of next $1,000 of tuition/fees, per student		$ 1,500
Lifetime Learning Credit:		
after 6/30/98 and before 2003, 20% of $5,000 of tuition/fees		$ 1,000
after 2002, 20% of $10,000 of tuition/fees		$ 2,000
Education credits, phaseout ranges:		
joint filers, modified AGI	$ 80,000 —	$ 100,000
other filers, modified AGI	$ 40,000 —	$ 50,000
Student loan interest deduction:		
1998		$ 1,000
1999		$ 1,500
2000		$ 2,000
2001 or thereafter		$ 2,500
Student loan interest deduction, phaseout ranges:		
joint filers, modified AGI	$ 60,000 —	$ 75,000
other filers, modified AGI	$ 40,000 —	$ 55,000
Exclusion for employer-paid education:		
as extended for courses beginning before 6/1/00		$ 5,250
Education IRA, contribution limit per child		$ 500
Education IRA, phaseout ranges:		
joint filers, modified AGI	$ 150,000 —	$ 160,000
other filers, modified AGI	$ 95,000 —	$ 110,000

ESTATE AND GIFT TAXES

Unified gift & estate tax credit amount:	
1998	$ 625,000
1999	$ 650,000
2000 and 2001	$ 675,000
2002 and 2003	$ 700,000
2004	$ 850,000
2005	$ 950,000
2006 and thereafter	$ 1 million
Family-owned business exclusion	$1.3 million
Interest rate on deferred estate tax for closely-held business	2%

MISCELLANEOUS

Health insurance deduction for self-employed:	
1998 and 1999, percentage of costs	45%
by 2007, rising to	100%
Estimated tax underpayment, *de minimis* exemption	$ 1,000

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Tax Relief at the Cost of Additional Complexity: Making Sense of the Taxpayer Relief Act of 1997

The Taxpayer Relief Bill of 1997 (H.R. 2014), containing the biggest tax cut in more than 16 years, was passed by Congress on July 31, 1997, by an overwhelming bipartisan majority (House: 389-43; Senate 92-8). It was signed into law on August 5, 1997, thereby marking an end to the relatively quick, yet remarkable, journey of this significant legislation. With over 800 Internal Revenue Code amendments and nearly 300 new provisions, 150 of which are already effective, tax professionals must assimilate many changes in a short period of time.

More impressive than the girth of this legislation is the broad range of taxpayers affected by it. The Taxpayer Relief Act of 1997 (P.L. 105-34) makes sweeping Code changes affecting individuals, families, and investors, as well as small and large businesses. Key provisions provide for capital gains reductions; child tax credits; educational incentives; savings and investment incentives; alternative minimum tax reform; and estate, gift, and generation-skipping tax reform. In addition to these well-publicized tax breaks, the new law also includes numerous extensions, technical corrections, and simplification and revenue-generating provisions.

This tax relief does not come without a price as the Act introduces additional complexity into the Code. One needs only to ponder the interaction of the new child tax credit provisions with the already complex earned income tax credit, or review the manner in which capital gain breaks are being implemented, to conclude that Congress' previously stated goal of tax simplification has been all but abandoned. Other provisions, such as the phase-in of the new unified credit rates, take place over such an extended period of time that they present a different type of challenge for practitioners—how to provide cost-effective planning services for their clients over the drawn out phase-in periods.

Looking beyond its substance, this Act is also memorable for another reason. It represents the first time a President has canceled provisions from enacted legislation pursuant to his authority granted under the Line Item Veto Act (P.L. 104-130). On August 11, 1997, President Clinton indicated that he was striking two provisions from the Taxpayer Relief Act, as well as one non-tax provision from the Balanced Budget Act. By exercising his authority in this manner, the President suggested he hoped to deter future attempts of using targeted provisions in the tax law that lead to abuse or serve to benefit only a handful of taxpayers rather than the broader public interest.

As we go to press, the final outcome of the canceled provisions remains in question. The uncertainty surrounding it is due in part to the procedures set out in the Line Item Veto Act making it possible for Congress to ultimately override the presidential cancellation with a supermajority in both Houses of Congress; but more importantly, it is also due to the possibility of a successful legal challenge to the constitutionality of the Line Item Veto Act. CCH, in its coverage of the Act, cautions readers with respect to any explanation or amended Code section relating to a canceled provision. In addition, we have included a complete listing of the 79 provisions that were identified by the Joint Committee on Taxation as possible candidates for presidential cancellation at ¶ 12.

In this work, CCH is providing its customers with a single integrated reference tool that covers the Taxpayer Relief Act of 1997 as well as the tax provisions contained in the Balanced Budget Act of 1997 (P.L. 105-33) and the

Taxpayer Browsing Protection Act (P.L.105-35). All three Acts were passed by Congress just before the August recess, and each was signed into law by the President shortly thereafter. The Conference Report including the related bill text is available in a separate publication, *Taxpayer Relief Bill of 1997 (H.R. 2014),* dated July 31, 1997. This publication also includes the relevant bill text and committee reports for the tax-related provisions of the Balanced Budget Bill of 1997 (H.R. 2015).

Taken together, these Acts represent a formidable body of new tax law that will engage the minds and time of tax practitioners for years to come. CCH remains dedicated to helping the tax professional understand and work with these new laws by providing this complete and accurate analysis of the new legislation.

Mark Hevrdejs

Executive Editor

August 1997

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How to Use

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1997 TAX LEGISLATION: LAW, EXPLANATION AND ANALYSIS provides you with a CCH-explanation of the tax provisions of the Taxpayer Relief Act of 1997 (P.L.105-34), the Balanced Budget Act of 1997 (P.L. 105-33), and the Taxpayer Browsing Protection Act (P.L. 105-35). In conjunction with CCH editors, practitioners and academics have provided practical guidance and planning strategies and identified pitfalls to be avoided as a result of the 1997 tax law changes. Also included is the text of the provisions of the Internal Revenue Code that were amended, added, or repealed by these Acts, and the relevant controlling Committee Reports. Throughout the LAW, EXPLANATION AND ANALYSIS, references are made to these Acts, as applicable.

Here is a guide to the separate features herein:

HIGHLIGHTS

A summary of the Highlights of the three Acts precedes, and provides references to the CCH Explanations to give you a quick overview of the major provisions of the three Acts. The Highlights are topically arranged by subject and provide a means of entry into the Explanations. *See ¶ 5.*

CCH EXPLANATIONS

CCH-prepared Explanations of the Taxpayer Relief Act, the Balanced Budget Act, and the Taxpayer Browsing Protection Act have been integrated throughout and are arranged according to subject matter for ease of use. Each Explanation includes a discussion of background or prior law that helps to put the law changes in proper context.

Incorporated throughout the Explanations is expert commentary provided by practitioners and academics. This commentary highlights planning opportunities and strategies engendered by these Acts. Pitfalls to avoid are identified. Charts illustrating the ramifications of specific law changes are incorporated throughout the Explanations. Also, included is an introduction identifying those taxpayers affected by the 1997 tax law changes.

The explanatory paragraphs are followed by boldface amendment lines (1) indicating the Act section of the applicable Act and the Code section, added, amended, or repealed; and (2) providing cross references to the law and to the controlling Committee Reports reproduced. Unless otherwise indicated, all references in the amendment lines are to the Taxpayer Relief Act of 1997. The CCH Explanations begin at *¶ 65.*

INDEX. Because the topical or subject matter approach to new legislation is usually the easiest, you may access the material in the CCH Explanations through an extensive Index that covers all three Acts. *See page 1227.*

AMENDED CODE PROVISIONS

CCH has reflected the changes necessitated by the Taxpayer Relief Act, the Balanced Budget Act, and the Taxpayer Browsing Protection Act in the Internal Revenue Code provisions affected. Any changed or added portion is set out in italics. The underlying Act making the change is identified for clarity and ease of

use. Deleted material or the text of the Code provision prior to amendment appears in the Amendment Notes following each reconstructed Code provision. **The applicable date for each Amendment Note is set out in boldface type.** At the end of each amended Code provision—and before the Amendment Note—CCH provides references to (1) the corresponding controlling Committee Reports; and (2) the CCH explanation of that amended, added, or repealed Code provision. *The text of the Code begins at ¶ 5001.*

NON-CODE PROVISIONS

The sections of the Taxpayer Relief Act and the Balanced Budget Act that do *not* amend the Internal Revenue Code appear in full text in Act section order. The applicable underlying Act is identified. Included is the text of Act sections that amend prior tax acts, such as the Small Business Job Protection Act of 1996, the Health Insurance Portability and Accountability Act, the Uruguay Round Agreements Act (GATT), and the Employee Retirement Income Security Act of 1974 (ERISA).

The text of these provisions appears in Act section order beginning at ¶ 7001.

EFFECTIVE DATES

Charts listing the major effective dates provide you with a reference bridge between Code sections and Act sections and indicate the retroactive or prospective nature of the laws explained. A separate table of effective dates is provided for the Taxpayer Relief Act *(see ¶ 15)*, the Balanced Budget Act *(see ¶ 17)*, and the Taxpayer Browsing Protection Act *(see ¶ 19)*.

SPECIAL FINDING DEVICES

There are tables indicating Code sections added, amended, or repealed *(see ¶ 25)*, provisions of other acts that were amended *(see ¶ 35)*, Act sections not amending Internal Revenue Code sections *(see ¶ 45)*, and Act sections amending Code sections *(see ¶ 55)*, so that you can immediately determine whether a provision in which you are interested is affected. A table cross referencing Code sections to the CCH Explanations is also included *(see ¶ 60)*.

Each Explanation chapter is preceded by a chapter table of contents listing the chapter contents. A detailed Table of Contents for LAW, EXPLANATION AND ANALYSIS is also included for easy identification of subject matter. *See page 11.*

COMMITTEE REPORTS

The Controlling Committee Reports officially explain the intent of Congress regarding the provisions of the three Acts. *These Controlling Committee Reports—House, Senate, and Conference Committee Reports—appear in Act section order for each Act beginning at ¶ 10,001.*

CLIENT LETTERS

Client letters explaining the ramifications of the tax law changes are included in the Appendix. These memoranda are intended for use by practitioners to help clients understand the recent law changes and the effect on a client's tax, financial, or estate plan. Sample client letters on: comprehensive tax planning, investment planning, IRA savings opportunities, education tax strategies, and estate planning are provided. *See page 1215.*

Highlights

¶ 5

INDIVIDUALS

Standard Deduction. The standard deduction for an individual who can be claimed as a dependent on another taxpayer's return is equal to the lesser of (1) the standard deduction for individuals or (2) the greater of $500 or the sum of $250 and the dependent's earned income . . . . ¶ 101

Charitable Contributions. The deduction for donations of appreciated stock to private foundations has been extended through June 30, 1998. . . . . ¶ 105

Deduction for Charitable Mileage. The standard mileage rate that is to be used in computing the deduction for charitable use of an automobile has been increased to 14 cents per mile for post-1997 tax years . . . . ¶ 107

Home Office Deduction. The definition of a taxpayer's "principal place of business" has been expanded for purposes of claiming a home office expense deduction. The office must be used to conduct business-related administrative or management activities, and there can be no other fixed business location where such activities take place . . . . ¶ 109

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Earned Income Credit (EIC). A 10-year ineligibility period applies to taxpayers who fraudulently claim earned income credits, and a two-year disallowance period applies to those who erroneously claim EICs. Determinations of fraud or of reckless or intentional disregard of the rules and regulations are to be made in deficiency proceedings. Also, failure by a return preparer to comply with due diligence requirements when preparing a refund claim or a return claiming the EIC can result in liability for a $100 penalty . . . . ¶ 127

Sale of Principal Residence. Effective for transactions after May 6, 1997, taxpayers who sell or exchange property that they owned and occupied as a principal residence for at least two of the five years preceding the sale or exchange can elect a $250,000 ($500,000 for joint filers) exclusion from income of gain realized on the sale or exchange. This new exclusion replaces the one-time exclusion from income by taxpayers age 55 or over and the deferral of gain under Code Sec. 1034, which was repealed . . . . ¶ 129

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Police Officers and Firefighters. Full-time police or fire department employees who received payments on account of heart disease or hypertension during 1989, 1990, and 1991 and who separated from service before July 1, 1992, can exclude those benefits from income. Claims for credit or refund of tax overpayments for those years must be filed by August 5, 1998 . . . . ¶ 135

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ESTATE AND GIFT TAX AND TRUSTS

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BUSINESS AND INVESTMENT

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Research Credit. The credit for qualified research expenditures has been retroactively reinstated and extended through June 30, 1998 .... ¶ 317

Work Opportunity Credit. The work opportunity tax credit, which can be claimed by employers hiring individuals from certain targeted groups, has been extended to cover wages paid to employees who begin work before July 1, 1998. The credit percentage has been modified and a new targeted group, composed of persons receiving supplemental security income benefits for any month ending within the 60-day period ending on the hiring date, has been added .... ¶ 318

Welfare-to-Work Credit. Employers can claim a new welfare-to-work credit for wages paid to recipients of long-term family assistance who begin work after 1997. The credit is equal to 35% of the first $10,000 of eligible wages in the first year of employment and 50% of the first $10,000 of eligible wages in the second year of employment. .... ¶ 320

Orphan Drug Credit. The credit for qualified clinical testing expenses incurred with respect to certain drugs used to treat rare diseases or conditions has been retroactively reinstated and made permanent .... ¶ 319

General Business Credit. The carryback period for the general business credit has been reduced from three years to one year, and the carryforward period has been increased from 15 years to 20 years for credits arising in tax years beginning after 1997 .... ¶ 321

Exclusion for Qualified Lessee Construction Allowances. Rent reductions or funds received by a lessee from its lessor under a short-term lease of retail space are excludable from income if the amounts are used for qualified construction or improvements to the space in connection with the lessee's trade or business .... ¶ 322

Income Forecast Method of Depreciation. Only film, video tape, sound recordings, copyrights, books, patents, and other property to be specified in regulations are subject to the income forecast method of depreciating trade or business assets. Consumer durables subject to rent-to-own contracts are ineligible for the income forecast method; instead, they have a three-year recovery period and a four-year class life for purposes of the modified accelerated cost recovery system .... ¶ 325

Percentage Depletion for Marginal Production. The 100% taxable income limit on the deduction for percentage depletion with respect to oil and gas properties is temporarily suspended for marginal properties for tax years beginning after 1997 and before 2000 .... ¶ 326

Environmental Cleanup Costs. An election to deduct currently amounts paid or incurred for the cleanup of certain hazardous substances can be made through December 31, 2000. Failure to make such an election will result in classification of the costs as capital expenses .... ¶ 330

Employer-Provided Meals. Employer-provided meals the value of which is excludable by employees under Code Sec. 119 qualify as a *de minimis* fringe benefit, and the expense is fully deductible by the employer .... ¶ 332

Inventory Shrinkage. A business that normally takes a physical count of its inventories on a regular and consistent basis and that appropriately adjusts the inventories and its methods of estimation does not have to take an actual year-end inventory in order to determine whether shrinkage—inventory loss attributable to undetected theft—has occurred .... ¶ 340

Mark-to-Market Election for Certain Traders and Dealers. In addition to securities dealers, commodities dealers and traders of securities or commodities can now elect to use the mark-to-market accounting method .... ¶ 341

Installment Sales. Manufacturers of tangible personal property will not be able to use the installment method to report income from sales to their dealers in tax years beginning after August 5, 1998 .... ¶ 343

Farmers. An individual engaged in the business of farming can make an irrevocable election to average farm income over a three-year period. One-third of "elected farm income" must be allocated to each of the prior three tax years ... ¶ 361

Installment Method of Accounting. For AMT purposes, farmers may use the installment method of accounting for income from the disposition of property used or produced in the trade or business of farming .... ¶ 363

Livestock Sales. Cash-method farmers who are forced to sell certain livestock due to flooding or other weather-related conditions can elect to defer recognition of gain on the sale or to treat the sale as an involuntary conversion .... ¶ 367

Empowerment Zones. The designation of two new urban-area empowerment zones under the present-law criteria, as well as 20 additional empowerment zones with expanded eligibility criteria, have been authorized. Certain tax incentives for the new zones have been modified or disallowed, and special eligibility rules apply to nominated areas in Alaska and Hawaii. Newly created empowerment zone bonds are not subject to the volume cap applicable to private activity bonds .... ¶ 371-379

District of Columbia Tax Incentives. Additional census tracts located in the District of Columbia that have a poverty rate of 20% or higher have been designated as the District of Columbia Enterprise Zone for a five-year period beginning in 1998. Businesses and individuals residing in the Zone are eligible for special tax incentives .... ¶ 381-387

PARTNERSHIPS AND S CORPORATIONS

Basis Allocation for Distributed Properties. The basis allocation rules applicable to partnership property distributions have been modified. A distributee partner's basis is allocated first to unrealized receivables and inventory items in an amount equal to the partnership's basis in each of the properties and then to other distributed properties to the extent of the partnership's basis in those properties.. ¶ 403

Section 751 Property. The substantial appreciation requirement for inventory is removed from the definition of Section 751 property with respect to sales or exchanges of partnership interests .... ¶ 410

Electing Large Partnerships. Simplified reporting requirements have been established for electing large partnerships. Eligible entities include partnerships that had 100 or more partners, other than service partners, during the preceding tax year. An electing large partnership will not terminate for tax purposes merely because 50% or more of its interests are sold or exchanged within a 12-month period. Most items of partnership income and deductions are combined at the partnership level, and net amounts are passed through to the partners. Passive loss limitation activities must be separately reported .... ¶ 412-420

Special Audit Procedures. A special audit system has been created for qualifying large partnerships that elect to apply the new, simplified flow-through reporting system. A partnership is ineligible to elect simplified reporting if its principal business is the buying and selling of commodities or if substantially all of the partners perform substantial services for the entity . . . . ¶ 421-430

Partnership Representative. Each electing large partnership must designate a partner or other person who will have the sole authority to act on behalf of the entity; if no such designation is made, the IRS can designate any one of the partners as the person authorized to act on the entity's behalf. However, the partnership can subsequently designate another partner to replace the IRS appointee . . . . ¶ 424

Deceased Partner. A partnership's tax year closes with respect to a partner whose entire interest in the entity terminates due to death, liquidation, or otherwise . . . . ¶ 465

Small Business Trusts. Charitable remainder unitrusts and charitable remainder annuity trusts have been added to the list of trusts that do not qualify as electing small business trusts that can hold stock in S corporations . . . . ¶ 473

CORPORATIONS AND SPECIAL ENTITIES

Gain Recognition on Corporate Spin-Offs. New restrictions have been imposed regarding the application of nonrecognition-of-gain treatment with respect to the acquisition and disposition of stock of a distributing or controlled corporation. If either entity is acquired pursuant to a plan or arrangement in existence on the date of distribution, gain is generally recognized by the other corporation as of that date. These new rules limit a company's ability to dispose of a portion of its business to new shareholders without recognizing gain. The-gain recognition provisions apply when one or more persons acquire a 50% or greater interest in either the distributing or controlled corporations pursuant to a plan or series of related transactions . . . . ¶ 503

Dividends-Received Deduction. A corporate shareholder is not entitled to a dividends-received deduction unless the applicable holding period for the dividend-paying stock is met with respect to each dividend received . . . . ¶ 517

Contributions of Computer Technology. Certain gifts of computer technology and equipment by C corporations to elementary or secondary schools qualify for an "augmented charitable deduction" in post-1997 tax years. The donated property must fit productively into the school's education plan . . . . ¶ 519

Alternative Minimum Tax. For tax years beginning after 1997, small corporations that meet a $5 million gross receipts test are not subject to AMT. Liability for AMT applies prospectively only for entities that cease to be small corporations . . . . ¶ 525

Depreciation Adjustment. The recovery periods used for purposes of the AMT depreciation adjustment have been conformed to the recovery periods used for purposes of the regular tax with respect to property, including pollution control facilities, placed in service after 1998 . . . . ¶ 527

Real Estate Investment Trusts (REITs). A number of REIT provisions have been modified, effective for tax years beginning after August 5, 1997. . ¶ 539-561

Penalties for Failure to Ascertain Ownership. For any tax year in which a REIT failed to comply with regulations on ascertaining ownership, it will not be disqualified, but it will have to pay, on notice and at the IRS's demand, a $25,000 penalty ($50,000 for intentional disregard) . . . . ¶ 539

Impermissible Tenant Services Income. A REIT may receive a small amount of impermissible tenant services income without causing all amounts received from the tenant to fail to qualify as rent . . . . ¶ 541

Constructive Ownership of Stock. A special 25% attribution rule will apply when determining whether a partner's stock is attributed to the partnership for purposes of assessing whether a REIT or its shareholders own an impermissible amount of a REIT tenant or independent contractor . . . . ¶ 543

Retention of Long-Term Capital Gains. A REIT may elect to retain, rather than distribute, and pay the tax on its net long-term capital gains. Although the shareholders must then include their proportionate shares of the undistributed gains in income and pay tax on them, they will receive a credit for the amount of tax paid by the REIT . . . . ¶ 545

30% Gross Income Test Repealed. A REIT is no longer subject to the restriction that it derive less than 30% of its gross income from the sale or disposition of stock or securities held for less than one year; certain real property held less than four years; and property in a prohibited transaction . . . . ¶ 547

TAX-EXEMPT ORGANIZATIONS

State-Sponsored Health Care Coverage. The category of persons eligible to receive medical care coverage from nonprofit, state-sponsored organizations that provide medical care has been expanded to include the child and spouse of a person who qualifies as a high-risk individual, provided that certain conditions are satisfied . . . . ¶ 603

Provider-Sponsored Organization. An exempt organization can participate in a joint venture with a for-profit organization if the venture furthers a charitable purpose and the sharing of profits and losses does not privately inure to, or substantially benefit, any individual . . . . ¶ 606

Sponsorship Payments. Certain qualified sponsorship payments that are solicited and received by an exempt organization are not subject to the unrelated business income tax. There can be no arrangement between the payor and the organization that results in the payor's receipt of a substantial return benefit . . ¶ 611

Timeshare Associations. Qualifying timeshare associations may elect to be taxed at a rate of 32% on their timeshare association income . . . . ¶ 616

PENSIONS AND QUALIFIED PLANS

Anti-Alienation Rules. A limited exception to the anti-alienation rules permits the reduction of employee pension plan benefits with respect to participants who have breached their fiduciary duty to, or committed criminal acts against, the plan . . . . ¶ 703

Involuntary Cash-Outs. The limit on involuntary qualified plan cash-outs has been increased to $5,000. Thus, when an employee's plan participation terminates, the employer can pay out the balance to the employee's credit without obtaining the employee's consent provided that the present value of the benefit does not exceed $5,000 . . . . ¶ 706

Prohibited Transactions Tax. The initial level of the two-tier tax on prohibited transactions between a qualified plan and a disqualified person has been increased to 15% . . . . ¶ 712

Excess Distribution Tax. Both the 15% excise tax on excess distributions from qualified retirement plans, tax-sheltered annuities, and IRAs and the 15% estate tax on excess retirement accumulations have been repealed . . . . ¶ 714

Full-Funding Limit. The current 150% full-funding limit on contributions that can be made to defined benefit pension plans is incrementally increased over a seven-year period to 170% for plan years that begin in 2005 and later .... ¶ 717

Matching Contributions for Self-Employed Individuals. Matching contributions made to 401(k) plans on behalf of self-employed individuals are not treated as matching contributions for employees and, thus, are not subject to elective contribution limits. This provision does not apply to qualified matching contributions that are treated as elective contributions for purposes of satisfying the average deferral percentage test .... ¶ 729

Savings Incentive Match Plans for Employees (SIMPLEs). Elective contributions of up to $6,000 per year (subject to cost-of-living adjustments (COLAs)) may be made by employees to their SIMPLE IRAs, and the $6,000 employee deferral can be matched by the employer .... ¶ 735-741

SIMPLE 401(k) Arrangements. An employer's deduction for contributions to a SIMPLE 401(k) plan is limited to the greater of (1) 15% of the compensation paid or accrued during the tax year to beneficiaries under the stock bonus or profit-sharing plan or (2) the amount that it is required to contribute to the plan for the year. Contributions that exceed the deduction limit can be carried over and deducted in subsequent years. The $6,000 annual limit on elective deferrals is subject to COLAs .... ¶ 743-749

Permissive Service Credits. When applying defined benefit plan limits, the annual benefit under a state or local governmental plan includes accrued benefits derived from the participant's voluntary contributions to purchase permissive service credits, which are credits for service with another governmental employer .... ¶ 760

HEALTH AND LIFE INSURANCE

Medical Savings Accounts. For AMT purposes, the 15% additional tax on medical savings account (MSA) distributions used for nonmedical purposes is not treated as a tax liability .... ¶ 801

Permitted Coverage. Individuals who have Medicare supplemental insurance are ineligible to maintain MSAs .... ¶ 804

MedicarePlus Choice MSA Pilot Program. A four-year pilot program allowing eligible senior citizens to establish "MedicarePlus Choice MSAs" has been authorized for post-1998 tax years. Funds held in the accounts are to be used only to pay for the account holders' "qualified medical expenses" .... ¶ 817-829

Company-Owned Life Insurance (COLI). The premium deduction limitation applicable to COLI has been modified to deny a deduction for interest paid in connection with insurance policies or annuity contracts covering the life of an individual in whom the taxpayer has an insurable interest. This limitation extends to parties who are or were officers or employees of, or who are or were financially interested in, any trade or business carried on currently or formerly by the taxpayer .... ¶ 845, 848

Variable Rate Contracts. The election of a fixed period during which the applicable interest rate limitation will apply must be made no later than November 3, 1997. It will apply to the taxpayer's first tax year ending on or after October 13, 1995, and to all subsequent tax years, unless revoked with IRS consent .... ¶ 851

Increased Health Insurance Deduction for Self-Employed Individuals. The business expense deduction allowed to self-employed taxpayers for health insurance for themselves and for their spouses and dependents will increase to

100% by 2007. The phase-in schedule for the increased deductibility rates has been accelerated . . . . ¶ 863

Group Health Plans. Provisions of the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996 relating to group health plans have been incorporated into the Internal Revenue Code. Employers whose group health plans fail to comply with those provisions will be subject to an excise tax of $100 per day for each affected individual . . . . ¶ 865

FOREIGN TAXPAYERS AND INVESTMENTS

Foreign Tax Credit (FTC) Limitation for Individuals. Individuals with $300 or less ($600 or less for joint filers) of creditable foreign taxes can elect to be exempt from the FTC limitation, provided that their only income from foreign sources is passive . . . . ¶ 904

Foreign Tax Credit for AMT Purposes. Exceptions to the rule limiting a taxpayer's foreign tax credit to 90% of the taxpayer's pre-credit tentative minimum tax have been repealed. Also, the FTC limitation formula, for AMT purposes, is simplified so that taxpayers are not required to recompute deductions in arriving at foreign-source AMT income . . . . ¶ 907, 910

FTC Limitations on Dividends from 10/50 Companies. The requirement that a separate FTC limitation be applied to dividends from each 10/50 company has been simplified. Generally, for pre-2003 earnings, dividends from all 10/50 companies are thrown into a single FTC limitation category . . . . ¶ 915

Indirect FTC for Lower-Tier Controlled Foreign Corporations (CFCs). The indirect foreign tax credit is extended to taxes paid or accrued by fourth-, fifth-, and sixth-tier CFCs, provided that stock ownership requirements are met . . . . ¶ 934

Exception to Subpart F Rules for Active Financing Income. The income of a foreign bank or other financial institution, if earned in the active conduct of a financial services business during its 1998 tax year, will not be treated as Subpart F income to U.S. 10% shareholders . . . . ¶ 942

Passive Foreign Investment Company (PFIC) Overlap with CFCs Eliminated. A CFC will not be treated as a PFIC with respect to 10% U.S. shareholders who are subject to income inclusions under Subpart F. The PFIC provisions continue to apply to shareholders not subject to Subpart F and for periods during which a shareholder's ownership is less than 10% . . . . ¶ 944

Mark-to-Market Election for Marketable PFIC Stock. A U.S. shareholder of a PFIC may make a mark-to-market election with respect to marketable PFIC stock. Under the election, the shareholder must include in income the excess of the stock's value over his basis in the stock at the close of the tax year and make a corresponding basis adjustment . . . . ¶ 946

Foreign Sales Corporations (FSCs). Computer software may qualify as export property eligible for FSC tax benefits, even if it has been licensed for reproduction abroad . . . . ¶ 950

Code Sec. 1491 Excise Tax Repealed. The 35% excise tax and related provisions of Code Secs. 1491-1494 are repealed. In general, transfers of property to foreign trusts and estates that had received nonrecognition treatment but were subject to the excise tax are now taxable. Similarly, property contributions to foreign partnerships will be subject to gain recognition to the extent provided by regulations . . . . ¶ 968

Transfers of Intangibles to Foreign Partnerships. Transfers of intangible property to foreign partnerships are made subject to the deemed royalty rule of Code Sec. 367(d) to the extent provided by regulation. In addition, the mandatory treatment of such deemed royalties as U.S.-source income was repealed . . . ¶ 969

Information Reporting for Foreign Entities. In connection with the repeal of Code Sec. 1494(c), information reporting on foreign partnerships, particularly those controlled by U.S. persons, is strengthened and brought into line with the reporting obligations of U.S. shareholders of controlled foreign corporations . . . ¶ 981-990

Treaty Benefits for Hybrid Entities. Under some circumstances, foreign residents in countries that have income tax treaties with the United States are not entitled to the treaty's reduced withholding rate on income that is not taxed in the country of residence and is derived through a partnership or other fiscally transparent entity . . . ¶ 992

COMPLIANCE AND TAX ADMINISTRATION

Waiver of Civil Penalties. The list of penalties that can be waived if a taxpayer establishes reasonable cause and good faith has been expanded . . . ¶ 1001

Sanctions for Unauthorized Browsing. The prohibition against browsing has been expanded. Criminal sanctions and civil damages may be imposed against federal employees, IRS contractors, state employees, and other persons who make willful or negligent unauthorized inspections of any tax returns or return information . . . ¶ 1004, 1007

Clarification of Period for Filing Refund Claims. Taxpayers who failed to file a return prior to the issuance of a deficiency notice and who successfully challenge the deficiency before the Tax Court are eligible to recover overpayments during the three-year period preceding the notice's mailing date . . . ¶ 1010

Liens and Levies. A levy of up to 15% on all specified payments made to, or received by, a taxpayer is continuous from the date on which it is first made until its release. If approved by the Treasury Secretary, workers' compensation payments, certain railroad annuity or pension payments, unemployment benefits, and means-tested public assistance are subject to continuous levy . . . ¶ 1019, 1022

Tax Court Procedure. A Tax Court order requiring the IRS to refund an overpayment is appealable in the same manner as a final decision. However, the court lacks jurisdiction over the validity or the merits of credits or offsets applied to reduce or eliminate a tax refund. Taxpayers may now file motions, rather than petitions, to seek a redetermination of interest in the Tax Court. Also, in limited circumstances, the Tax Court has jurisdiction to make determinations regarding employment status . . . ¶ 1025-1031

Electronic Tax Payments. Small businesses will not be penalized for failing to make federal tax deposits using the Electronic Federal Tax Payment System through June 30, 1998 . . . ¶ 1040

Reporting Requirements for Sale of Residence. Sales of principal residences that generate a gross sales price of $250,000 or less ($500,000 in the case of married sellers) are not subject to the real estate transaction reporting rules provided that certain requirements are met . . . ¶ 1050

Tax Shelters. Certain confidential arrangements are now treated as tax shelters and are subject to the registration and notification requirements. Also, in some instances, persons other than the promoters must satisfy the registration requirements . . . ¶ 1058

IRS-Montana Demonstration Project. For a five-year period, taxpayers in Montana are to report state and federal employment tax information on one form pursuant to a demonstration project developed jointly by the IRS and Montana . . . . ¶ 1064

Disaster Areas. The IRS is authorized to issue regulations postponing, for a period of up to 90 days, certain deadlines applicable to taxpayers affected by Presidentially declared disasters . . . . ¶ 1067

Disclosure of Audits Involving Prospective Jurors. The Treasury Secretary can no longer disclose whether a prospective juror in a criminal or civil tax proceeding has been the subject of an audit or other IRS investigation . . . . ¶ 1070

ESTIMATED TAX, WITHHOLDING, EMPLOYMENT TAXES

Penalty for Underpayment of Estimated Tax. The penalty for underpayment of estimated tax will not be imposed against an individual whose net underpayment for the year is less than $1,000 . . . . ¶ 1101

Estimated Tax Safe Harbor Modified. To avoid liability for the estimated tax penalty, individuals whose adjusted gross incomes exceeded $150,000 for the preceding tax year must pay an amount equal to the lesser of 90% of the current year's tax or 105% of their prior year's tax liability if the preceding year begins in 1998, 1999, or 2000; 112% if the preceding tax year begins in 2001; and 110% if the preceding tax year begins in 2002 or thereafter . . . . ¶ 1103

Tax Payments by Commercially Acceptable Means. The IRS can accept tax payments by any means deemed appropriate in regulations. This may include remittances made using credit cards, debit cards, or charge cards . . . . . . ¶ 1111

Termination Payments to Insurance Salespersons. Post-1997 termination payments made to insurance salespersons who worked as independent contractors are excludable from self-employment net earnings provided that certain requirements are met . . . . ¶ 1117

EXCISE TAXES

Airport and Airway Ticket Taxes. Excise taxes applicable to domestic and international air passengers, air cargo, and aviation fuels have been extended through September 30, 2007. The current 10% tax on domestic passenger transportation is lowered incrementally to 7.5%, and a new flight segment fee is imposed. Also, a $12 arrival and departure tax applies to international flights that begin or end in the United States . . . . ¶ 1201

Diesel Fuel Tax. The diesel fuel tax has been repealed with respect to fuel used in recreational motorboats . . . . ¶ 1209

Heavy Trucks and Luxury Cars. After-market installations of parts and accessories in heavy trucks or luxury cars that exceed a threshold price of $1,000 are subject to an excise tax . . . . ¶ 1241, 1245

LUST Trust Fund Tax. The one-cent-per-gallon Leaking Underground Storage Tank Trust Fund tax imposed on certain fuels has been reinstated for the period beginning after September 30, 1997, and before April 1, 2005 . . . . ¶ 1251

Communications Tax. For purposes of the excise tax on long-distance telephone service, the face amount of a prepaid telephone card is treated as the amount paid for such services. Also, payment is considered to be made when the card is transferred by a telecommunications carrier to a noncarrier . . . . ¶ 1253

Tax on Vaccines. A new, single vaccine tax rate of 75 cents per dose is imposed on any listed vaccine component . . . . ¶ 1255

Cigarette Tax. Excise taxes on tobacco products are increased for post-1999 tax years and have been extended to roll-your-own tobacco . . . . ¶ 1257

Provisions Dropped in Conference

¶ 10

The following proposed law changes originally included in the House or Senate versions of the Taxpayer Relief Act, were dropped by the conferees. References to the House bill are to the Taxpayer Relief Bill of 1997, as passed by the House on June 26, 1997. References to the Senate bill are to the Revenue Reconciliation Bill of 1997, as passed by the Senate on June 27, 1997, with floor amendments. Note that the House changed the name of its version of the tax bill from the Revenue Reconciliation Bill of 1997 to the Taxpayer Relief Bill of 1997.

Individuals

1. Indexing of the dependent care credit for inflation (House Sec. 102).

2. Phase-out of the Code Sec. 117(d) tuition exclusion for employees of educational organizations (House Sec. 202(c)).

3. A tax credit for expenses of obtaining supplementary elementary and secondary education (House Sec. 204).

4. Deduction for qualified professional development expenses incurred by elementary or secondary school teachers not treated as miscellaneous itemized deduction subject to two-percent AGI floor (Senate Sec. 224).

5. Increase in AMT exemption amounts (House Sec. 401; Senate Sec. 102 (Floor amendment no. 574)).

6. Certain employee flights on employer aircraft treated as an excludable fringe benefit (House Sec. 916).

7. Gain or loss from sale of livestock disregarded for purposes of earned income credit disqualified income test (Senate Sec. 722).

8. Elimination of the 10-percent AGI floor for casualty losses resulting from a presidentially declared disaster (Senate Sec. 725 (Floor amendment no. 560)).

9. Taxpayers employed on qualified construction projects considered temporarily away from home for purposes of deducting travel expenses (Senate Sec. 775).

10. Charitable contribution deduction for expenses incurred in carrying out sanctioned whaling activities (Senate Sec. 776).

11. Repeal of exclusion for income from residence rentals of less than 15 days per year (House Sec. 1069).

12. $2,000 exclusion for severance payments where reemployment is not obtained within six months at 95 percent or more of previous pay (Senate Sec. 788(a) (Floor amendment no. 578)).

Estate and Gift Tax

1. Extension of maximum estate tax installment period to 24 years (House Sec. 502; Senate Sec. 404).

2. Unified credit increased when split-gift property included in both spouses' estates (House Sec. 508).

3. Qualified reformation allowed to correct defective power of appointment or QTIP trust (House Sec. 509).

4. Special treatment of severed trusts for generation-skipping transfer tax purposes (House Sec. 511).

5. Qualified disclaimer rules under Code Sec. 2518 modified to allow a transfer-type disclaimer of an undivided portion of a disclaimant transferor's interest in property (House Sec. 1304).

6. Increase on the limitations relating to the exercise or release of a general power of appointment from the greater of $5,000 or five percent to the greater of $10,000 or five percent (House Sec. 1305).

7. Tax year of an estate limited to a year ending on October 31, November 30, or December 31 (House Sec. 1311).

Business and Investment

1. Inflation adjustment to basis of certain assets held for more than three years by a noncorporate taxpayer (House Sec. 312).

2. Current refunding for certain tax-exempt bonds issued by Indian tribal governments (Senate Sec. 789 (Floor amendment no. 586)).

3. A tax credit for providing child care facilities for employees (Senate Sec. 103 (Floor amendment no. 575)).

4. New statutory safe-harbor for classification as an independent contractor (House Sec. 934).

5. Two-year extension of credit for electricity produced from wind and closed-loop biomass (Senate Sec. 771)

6. Extension of 54 cents per gallon income tax credit for ethanol through December 31, 2007 (Senate Sec. 707).

Employment Taxes

1. Farm and nonfarm optional methods for computing SECA tax combined into a single optional method applicable to all self-employed workers (House Sec. 1203).

State and Local Bonds

1. Maximum capital expenditure limit for qualified small-issue bonds increased from $10 million to $20 million (Senate Sec. 770).

2. Bonds guaranteed by the Federal Home Loan Bank Board not treated as federally guaranteed for purposes of the federal guarantee prohibition generally applicable to tax-exempt bonds (Senate Sec. 774).

Corporations and Special Entities

1. 50-percent exclusion for gain on small business stock held by a corporation (Senate Sec. 312).

2. Interest deductions of corporations (other than insurance companies) disallowed in the same proportion as the average basis that its tax-exempt obligations bears to the average basis of all of its assets (House Sec. 1003).

3. Consolidation of two or more life insurance departments of mutual savings banks into a single life insurance company by requirement of state law treated as a tax-free Code Sec. 358(a)(1)(E) reorganization (House Sec. 962).

4. Special rule relating to repeal of bad debt reserve method for thrift associations that become large banks in their first tax year beginning after 1994 (Senate Sec. 790 (Floor amendment no. 587)).

Tax-Exempt Organizations

1. Income from qualified games of chance conducted by tax-exempt organization exempted from unrelated business income tax (Senate Sec. 783 (Floor amendment no. 559)).

2. Limitation on increase in basis of property resulting from sale by a tax-exempt entity to a related person (House Sec. 1052; Senate Sec. 852).

3. Exemption from reporting and proxy tax requirements for political and lobbying expenditures of certain tax-exempt organizations (House Sec. 1053).

Individual Retirement Accounts; Qualified Plans

1. Penalty-free IRA withdrawals for adoption expenses (Senate Sec. 105 (Floor amendment no. 585)).

2. Penalty-free distributions from IRAs to replace property damaged in presidentially declared disaster area (Senate Sec. 724 (Floor amendment no. 560)).

3. Elimination of the 100-percent-of-compensation limitation for multi-employer defined benefit pension plans (Senate Sec. 711).

4. Modification of partial termination (vesting) rules by amending Sec. 552 of the Deficit Reduction Act of 1984 (Senate Sec. 712).

5. Spousal consent required for distributions and loans from plans containing a qualified cash or deferred arrangement (Senate Sec. 714).

Foreign Taxpayers and Investment

1. Carryback period for foreign tax credit reduced from two years to one year; carryforward period extended from five years to seven years (Senate Sec. 867).

2. Penalty imposed for failure to file disclosure of exemption for income from the international operation of ships or aircraft by foreign persons (House Sec. 1174).

3. One-year suspension of 50-percent duty on repairs to U.S. flag vessels made in countries that are signatories to the OECD Shipbuilding agreement (House Sec. 972).

4. Additional trade benefits to Caribbean Basin Initiative (CBI) countries comparable to tariff and quota treatment under the North American Free Trade Agreement (NAFTA) on products not already eligible for CBI treatment subject to certain conditions and limitations (House Secs. 981—988).

Compliance and Tax Administration

1. Overpayments of federal tax allowed to be offset by the amount of any past-due, legally enforceable state tax obligation if return shows address within the state seeking offset (House Sec. 963)

2. Expansion of enforcement efforts between the IRS and HHS Office of Child Support Enforcement (Senate Sec. 104 (Floor amendment no. 575).

[illegible]

Items Subject to Cancellation Under Line Item Veto Act

¶ 12

On August 11, 1997, President Clinton exercised his authority under the Line Item Veto Act (P.L. 104-130) to "cancel" two tax provisions contained in the Taxpayer Relief Act of 1997 (P.L. 105-34).

The canceled provisions are:

(1) Act Sec. 968, which would have made the sale of stock of a qualified refiner or processor to a farmer's cooperative eligible for gain deferral under Code Sec. 1042. The item was canceled, according to a White House press release, because the provision was not drafted to ensure that the deferred tax would eventually be repaid. The estimated cost of the canceled provision would have been $98 million over five years. The provision is discussed at ¶ 369.

(2) Act Sec. 1175, which would have amended Code Sec. 954 to temporarily exclude certain overseas income derived in the active conduct of a banking, financing, or similar business from the definition of personal holding company income. This provision was canceled, according to the press release, because it would have permitted substantial abuse and created significant tax loopholes for a small number of major U.S. banks, financing companies, insurance companies, and securities firms. The estimated cost of the provision would have been $317 million over five years. The provision is discussed at ¶ 942.

CCH has included caution lines above the related explanations and Internal Revenue Code law changes to alert readers that these provisions were canceled. It should be noted, however, that the constitutionality of the Line Item Veto Act is uncertain at this time. Although the Act was previously challenged by certain members of Congress in *Franklin D. Raines et al. v. Sen. Robert C Byrd, et al.*, SCt, 97-2 USTC ¶ 50,500, the case was dismissed by the Supreme Court on the grounds that the members of Congress lacked standing. Thus, the canceled provisions may remain effective if the Act is successfully challenged in future litigation or, as explained below, a disapproval bill is enacted.

Line Item Veto Act

The Line Item Veto Act (P.L. 104-130) gives the President the authority to "cancel" limited tax benefits (provisions benefiting 100 or fewer taxpayers) contained in a revenue or reconciliation bill or joint resolution. A canceled provision is "without legal force or effect."

Procedurally, the Joint Committee on Taxation is required by the Line Item Veto Act to prepare a statement identifying each limited tax benefit contained in a bill or resolution. Conferees then determine whether to include the statement in the conference report. If the statement is included, the President may cancel one or more of the provisions identified within five calendar days (excluding Sunday) after enactment of the Act. If the statement is not included, then the President determines which provisions are subject to cancellation under the Act. Cancellation takes effect when the Senate and House receive a "special message" from the President providing notification of the cancellations. Expedited procedures allow the House and Senate to enact a "disapproval bill" which renders identified cancellations as "null and void." A disapproval bill must be enacted within 30 days and is subject to a traditional Presidential veto, which would have to be overridden by a two-thirds majority in each House.

Limited Tax Benefits Subject to Line Item Veto

The conference report for the Taxpayer Relief Act of 1997 identified the following provisions as subject to cancellation (Act. Sec. 1701 at ¶ 7085; Committee Report at ¶ 14,015). Provisions canceled by President Clinton are in bold.

(1) Act Sec. 101(c), relating to high-risk pools permitted to cover dependents of high-risk individuals (¶ 603);

(2) Act Sec. 222, relating to the limitation on qualified Code Sec. 501(c)(3) bonds other than hospital bonds (¶ 603);

(3) Act Sec. 224, relating to contributions of computer technology and equipment for elementary or secondary school purposes (¶ 519);

(4) Act Sec. 312(a), relating to treatment of remainder interests for purposes of the provision relating to gain on the sale of a principal residence (¶ 129);

(5) Act Sec. 501(b), relating to indexing of alternate valuation of certain farm or real property (¶ 204);

(6) Act Sec. 504, relating to extending treatment of certain rents under Code Sec. 2032A to lineal descendants (¶ 229);

(7) Act Sec. 505, relating to clarification of judicial review of eligibility for extension of time for payment of estate tax (¶ 225);

(8) Act Sec. 508, relating to treatment of land subject to qualified conservation easement (¶ 214);

(9) Act Sec. 511, relating to expansion of exception from generation-skipping transfer tax for transfers to individuals whose parents are deceased (¶ 249);

(10) Act Sec. 601, relating to the research tax credit (¶ 317);

(11) Act Sec. 602, relating to contributions of stock to private foundations (¶ 105);

(12) Act Sec. 603, relating to the work opportunity tax credit (¶ 318);

(13) Act Sec. 604, relating to the orphan drug tax credit (¶ 319);

(14) Act Sec. 701, relating to incentives for revitalization of the District of Columbia, to the extent it relates to tax-exempt economic development bonds (¶ 383);

(15) Act Sec. 701, relating to incentives for revitalization of the District of Columbia, to the extent it relates to a first-time homebuyer credit for the District (¶ 387);

(16) Act Sec. 801, relating to incentives for employing long-term family assistance recipients (¶ 320);

(17) Act Sec. 904(b), relating to uniform rates of tax on vaccines, as it relates to any vaccine containing pertussis bacteria, extracted or partial cell bacteria or specific pertussis antigens (¶ 1255);

(18) Act Sec. 904(b), relating to uniform rates of tax on vaccines, as it relates to any vaccine against measles (¶ 1255);

(19) Act Sec. 904(b), relating to uniform rates of tax on vaccines, as it relates to any vaccine against mumps (¶ 1255);

(20) Act Sec. 904(b), relating to uniform rates of tax on vaccines, as it relates to any vaccine against rubella (¶ 1255);

(21) Act Sec. 905, relating to operators of multiple retail gasoline outlets treated as wholesale distributors for refund purposes (¶ 1219);

(22) Act Sec. 906, relating to exemption of electric and other clean-fuel motor vehicles from luxury automobile classification (¶ 1247);

(23) Act Sec. 907(a), relating to the rate of tax on liquefied natural gas determined on the basis of BTU equivalency with gasoline (¶ 1216);

(24) Act Sec. 907(b), relating to the rate of tax on methanol from natural gas determined on the basis of BTU equivalency with gasoline (¶ 1216);

(25) Act Sec. 908, relating to modification of the tax treatment of hard cider (¶ 1276);

(26) Act Sec. 914, relating to mortgage financing for residences located in disaster areas (¶ 349);

(27) Act Sec. 962, relating to assignment of workmen's compensation liability eligible for exclusion relating to personal injury liability assignments (¶ 347);

(28) Act Sec. 963, relating to tax-exempt status for certain state worker's compensation act companies (¶ 601);

(29) Act Sec. 967, relating to additional advance refunding of certain Virgin Island bonds (¶ 351);

(30) Act Sec. 968, relating to nonrecognition of gain on the sale of stock to certain farmers' cooperatives (¶ 369);

(31) Act Sec. 971, relating to exemption of the incremental cost of a clean fuel vehicle from the limits on depreciation for vehicles (¶ 327);

(32) Act Sec. 974, relating to clarification of the treatment of certain receivables purchased by cooperative hospital service organizations (¶ 605);

(33) Act Sec. 975, relating to deduction in computing adjusted gross income for expenses in connection with service performed by certain officials, with respect to tax years beginning before 1991 (¶ 117);

(34) Act Sec. 977, relating to elective carryback of existing carryovers of National Railroad Passenger Corporation (¶ 565);

(35) Act Sec. 1005(b)(2)(B), relating to the transitional rule for instruments described in a ruling request submitted to the IRS on or before June 8, 1997 (¶ 513);

(36) Act Sec. 1005(b)(2)(C), relating to the transitional rule for instruments described on or before June 8, 1997, in a public announcement or in a filing with the Securities and Exchange Commission as it relates to a public announcement (¶ 513);

(37) Act Sec. 1005(b)(2)(C), relating to the transitional rule for instruments described on or before June 8, 1997, in a public announcement or in a filing with the Securities and Exchange Commission as it relates to a filing with the Securities and Exchange Commission (¶ 513);

(38) Act Sec. 1011(d)(2)(B), relating to the transitional rule for distributions made pursuant to the terms of a tender offer outstanding on May 3, 1995 (¶ 501);

(39) Act Sec. 1011(d)(3), relating to the transitional rule for distributions made pursuant to the terms of a tender offer outstanding on September 13, 1995 (¶ 501);

(40) Act Sec. 1012(d)(3)(B), relating to the transitional rule for distributions made pursuant to an acquisition described in Code Sec. 355(e)(2)(A)(ii) described in a ruling request submitted to the IRS on or before April 16, 1997 (¶ 503);

(41) Act Sec. 1012(d)(3)(C), relating to the transitional rule for distributions made pursuant to an acquisition described in Code Sec. 355(e)(2)(A)(ii) described in a public announcement or filing with the Securities and Exchange Commission as it relates to a public announcement (¶ 503);

(42) Act Sec. 1012(d)(3)(C), relating to the transitional rule for distributions pursuant to an acquisition described in Code Sec. 355(e)(2)(A)(ii) described in a public

announcement or filing with the Securities and Exchange Commission as it relates to a filing with the Securities and Exchange Commission (¶ 503)

(43) Act Sec. 1013(d)(2)(B), relating to the transitional rule for distributions or acquisitions after June 8, 1997, described in a ruling request submitted to the IRS on or before June 8, 1997 (¶ 505);

(44) Act Sec. 1013(d)(2)(C), relating to the transitional rule for distributions or acquisitions after June 8, 1997, described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997, as it relates to a public announcement (¶ 505);

(45) Act Sec. 1013(d)(2)(C), relating to the transitional rule for distributions or acquisitions after June 8, 1997, described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997, as it relates to a filing with the Securities and Exchange Commission (¶ 505);

(46) Act Sec. 1014(f)(2)(B), relating to the transitional rule for any transaction after June 8, 1997, if such transaction is described in a ruling request submitted to the IRS on or before June 8, 1997 (¶ 507);

(47) Act Sec. 1014(f)(2)(C), relating to the transitional rule for any transaction after June 8, 1997, if such transaction is described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997, as it relates to a public announcement (¶ 507);

(48) Act Sec. 1014(f)(2)(C), relating to the transitional rule for any transaction after June 8, 1997, if such transaction is described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997, as it relates to a filing with the Securities and Exchange Commission (¶ 507);

(49) Act Sec. 1042(b), relating to special rules for provision terminating certain exceptions from rules relating to exempt organizations which provide commercial-type insurance (¶ 607);

(50) Act Sec. 1081(a), relating to termination of suspense accounts for family corporations required to use the accrual method of accounting as it relates to the repeal of Code Sec. 447(i)(3) (¶ 365);

(51) Act Sec. 1089(b)(3), relating to reformations (¶ 281);

(52) Act Sec. 1089(b)(5)(B)(i), relating to persons under a mental disability (¶ 281);

(53) Act Sec. 1171, relating to treatment of computer software as FSC export property (¶ 950);

(54) Act Sec. 1175, relating to exemption for active financing income (¶ 942);

(55) Act Sec. 1204, relating to travel expenses of certain federal employees engaged in criminal investigations (¶ 115);

(56) Act Sec. 1236, relating to extension of time for filing a request for administrative adjustment (¶ 447)

(57) Act Sec. 1243, relating to special rules for administrative adjustment requests with respect to bad debts or worthless securities (¶ 449);

(58) Act Sec. 1251, relating to clarification of limitation on maximum number of shareholders (¶ 539);

(59) Act Sec. 1253, relating to attribution rules applicable to tenant ownership (¶ 543);

(60) Act Sec. 1256, relating to modification of earnings and profits rules for determining whether REIT has earnings and profits from non-REIT year (¶ 549);

(61) Act Sec. 1257, relating to treatment of foreclosure property (¶ 551);

(62) Act Sec. 1261, relating to shared appreciation mortgages (¶ 559);

(63) Act Sec. 1302, relating to clarification of waiver of certain rights of recovery (¶ 243);

(64) Act Sec. 1303, relating to transitional rule under Code Sec. 2056A (¶ 233);

(65) Act Sec. 1304, relating to treatment for estate tax purposes of short-term obligations held by nonresident aliens (¶ 212);

(66) Act Sec. 1311, relating to clarification of treatment of survivor annuities under qualified terminable interest rules (¶ 239);

(67) Act Sec. 1312, relating to treatment of qualified domestic trust rules of forms of ownership which are not trusts (¶ 235);

(68) Act Sec. 1313, relating to opportunity to correct failures under Code Sec. 2032A (¶ 231);

(69) Act Sec. 1414, relating to fermented material from any brewery may be received at a distilled spirits plant (¶ 1274);

(70) Act Sec. 1417, relating to use of additional ameliorating material in certain wines (¶ 1281);

(71) Act Sec. 1418, relating to domestically produced beer may be withdrawn free of tax for use by foreign embassies, legations, etc. (¶ 1286);

(72) Act Sec. 1421, relating to transfer to brewery of beer imported in bulk without payment of tax (¶ 1288);

(73) Act Sec. 1422, relating to transfer to bonded wine cellars of wine imported in bulk without payment of tax (¶ 1282);

(74) Act Sec. 1506, relating to clarification of certain rules relating to employee stock ownership plans of S corporations (¶ 752);

(75) Act Sec. 1507, relating to modification of 10-percent tax on nondeductible contributions (¶ 725);

(76) Act Sec. 1523, relating to repeal of application of unrelated business income tax to ESOPs (¶ 755);

(77) Act Sec. 1530, relating to gratuitous transfers for the benefit of employees (¶ 284);

(78) Act Sec. 1532, relating to special rules relating to church plans (¶ 770); (¶ 867) and

(79) Act Sec. 1604(c)(2), relating to the definition of Indian reservation under Code Sec. 168(j) (¶ 328).

Act Sec. 9304 (¶ 8010) of the Balanced Budget Act of 1997 (P.L. 105-33) identifies the following tax provision as subject to the Line Item Veto Act:

Act Sec. 5406, relating to an exemption from FUTA tax for persons committed to a penal institution (¶ 1126).

EFFECTIVE DATES

Taxpayer Relief Act of 1997

¶ 15

This CCH-prepared table presents the general effective dates for the substantive and major law provisions added, amended or repealed by the Taxpayer Relief Act of 1997 (P.L. 105-34), enacted August 5, 1997. Entries are listed in Code Section order.

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
	1(d)	Waiver of estimated tax penalties	Date of enactment
	311(e)	Maximum capital gains rate for individuals—election to recognize gain on assets held on January 1, 2001	Tax years ending after May 6, 1997
	909	Study of feasibility of moving collection points for distilled spirits excise tax	Report due not later than March 31, 1998
	915	Abatement of interest on underpayments by taxpayers in presidentially declared disaster areas	Disasters declared after December 31, 1996
	921	Clarification of standard to be used in determining employment tax status of securities brokers	Services performed after December 31, 1997
	931	Waiver of penalty through June 30, 1988, on small businesses failing to make electronic fund transfers of taxes	Date of enactment
	935	Moratorium on certain regulations	Date of enactment
	967	Additional advance refunding of certain Virgin Island bonds	Date of enactment
	976(a), (b)	Combined employment tax reporting demonstration project	Date of enactment
	977	Elective carryback of existing carryovers of National Railroad Passenger Corporation	Date of enactment
	981	Generalized system of preferences—extension of duty-free treatment under system	Date of enactment
	1026(b)(2)	Confidentiality and disclosure of returns and return information—conforming amendment	Levies issued after date of enactment
	1031(g)	Extension and modification of airport and airway trust fund taxes—delayed deposits of airport trust fund tax revenues	Date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
	1032(g)	Floor stock tax on kerosene	July 1, 1998
	1071(b)	Pension accrued benefit distributable without consent increased to $5,000—amendments to ERISA	Plan years beginning after date of enactment
	1088	Treatment of exception from installment sales rules for sales of property by a manufacturer to a dealer	Tax years beginning more than 1 year after date of enactment, generally
	1090(a)	Expansion of coordinated enforcement efforts of IRS and HHS Office of Child Support Enforcement	October 1, 1998
	1090(b)(1)(A)	Expanded SSA records for tax enforcement—required submission of SSN's on applications	Applications made after the date which is 180 days after the date of enactment
	1090(b)(1)(B), (C)	Expanded SSA records for tax enforcement—required submission of SSN's on applications	Information obtained on, before, or after date of enactment
	1161	Transition rule for certain trusts	Tax years beginning after December 31, 1996, generally
	1203(b)	Treatment of certain reimbursed expenses of rural mail carriers—technical amendment	Tax years beginning after December 31, 1997
	1303	Transitional rule under section 2056A	Decedents dying after November 10, 1988
	1462	Clarification of authority to withhold Puerto Rico income taxes from salaries of federal employees	January 1, 1998
	1504(b)	Modification of 403(b) exclusion allowance to conform to 415 modifications—repeal of rules in section 415(e)	Years beginning after December 31, 1999
	1509	Clarification of disqualification rules relating to acceptance of rollover contributions	Date of enactment
	1510	New technologies in retirement plans	Date of enactment
	1524	Diversification of section 401(k) plan investments	Elective deferrals for plan years beginning after December 31, 1998
	1529	Treatment of certain disability benefits received by former police officers or firefighters	Date of enactment
	1541	Provisions relating to plan amendments	Date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
	1601(d)(4)	Technical amendments related to Small Business Job Protection Act of 1996—clarification of treatment of indian tribal government plans.	August 20, 1996
	1601(f)(4)(E)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	August 27, 1996
	1601(f)(4)(F)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	August 27, 1996
	1601(g)(1)	Technical amendments related to Small Business Job Protection Act of 1996—extension of period for claiming refunds for alcohol fuels	January 1, 1994
	1601(h)(1)(C)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle H	Tax years ending after August 20, 1996, generally
	1601(i)(4)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle I	Tax years beginning after December 31,1996, generally
	1601(i)(4)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle I	Tax years beginning after December 31,1996, generally
	1602(f)(4), (5)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 501	Interest paid or accrued after December 31, 1995
	1604(b)(2)(B)	Miscellaneous provisions—amendments related to Uruguay Round Agreements Act	Plan years beginning after December 31, 1994
	1604(b)(3)	Miscellaneous provisions—amendments related to Uruguay Round Agreements Act	Plan years beginning after December 31, 1994
	1604(f)(3)	Miscellaneous provisions—amendments related to Balanced Budget Act of 1997	Articles removed after December 31, 1999, generally
	1701	Identification of limited tax benefits subject to line item veto	Date of enactment
1(h)	311(a)	Maximum capital gains rates for individuals	Tax years ending after May 6, 1997

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
23(a)(2)	1601(h)(2)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle H	Tax years beginning after December 31, 1996
23(b)(2)(B)	1601(h)(2)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle H	Tax years beginning after December 31, 1996
24	101(a)	Child tax credit	Tax years beginning after December 31, 1997
25(e)(7)	312(d)(1)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
25A	201(a)	Hope and lifetime learning credits	Expenses paid after December 31, 1997 (in tax years ending after such date), for education furnished in academic periods beginning after such date, generally
26(b)(2)(E)-(Q)	213(e)(1)	Education individual retirement accounts—technical amendments	Tax years beginning after December 31, 1997
26(b)(2)(N)-(P)	1602(a)(1)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 301	Tax years beginning after December 31, 1996
30A	1601(f)(1)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	Tax years beginning after December 31, 1995, generally
32(c)(2)(B)	1085(c)	Improved enforcement of the application of the earned income credit—workfare payments not included in earned income	Tax years beginning after December 31, 1997
32(c)(4)	312(d)(2)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
32(c)(5)(B)	1085(b), (d)	Improved enforcement of the application of the earned income credit	Tax years beginning after December 31, 1997
32(k)-(m)	1085(a)(1)	Restrictions on availability of earned income credit for taxpayers who improperly claimed credit in prior year	Tax years beginning after December 31, 1996
32(m)	101(b)	Child tax credit—supplemental credit	Tax years beginning after December 31, 1997

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
39(a)(1), (2)	1083	Modifications to tax years to which unused credits may be carried	Credits arising in tax years beginning after December 31, 1997
39(d)(8)	701(b)(1)	Tax incentives for revitalization of the District of Columbia—conforming amendments	Date of enactment
41(c)(4)(B)	601(b)(1)	Research tax credit—technical amendment	Amounts paid or incurred after May 31, 1997
41(h)(1)	601(a)	Research tax credit	Amounts paid or incurred after May 31, 1997
45C(b)(1)	601(b)(2)	Research tax credit—technical amendment	Amounts paid or incurred after May 31, 1997
45C(e)	604	Orphan drug tax credit	Amounts paid or incurred after May 31, 1997
51(a)	603(d)(1)	Work opportunity tax credit—percentage of wages allowed as credit	Individuals who begin work for the employer after September 30, 1997
51(c)(4)(B)	603(a)	Work opportunity tax credit—extension	Individuals who begin work for the employer after September 30, 1997
51(d)(1)(F)-(H)	603(c)(1)	Work opportunity tax credit—qualified SSI recipients treated as members of targeted groups	Individuals who begin work for the employer after September 30, 1997
51(d)(2)(A)	603(b)(1)	Work opportunity tax credit—modification of eligibility requirement based on period on welfare	Individuals who begin work for the employer after September 30, 1997
51(d)(3)(A)	603(b)(2)	Work opportunity tax credit—modification of eligibility requirement based on period on welfare	Individuals who begin work for the employer after September 30, 1997
51(d)(9)-(12)	603(c)(2)	Work opportunity tax credit—qualified SSI recipients treated as members of targeted groups	Individuals who begin work for the employer after September 30, 1997
51(i)(3)	603(d)(2)	Work opportunity tax credit—percentage of wages allowed as credit	Individuals who begin work for the employer after September 30, 1997
51A	801(a)	Incentives for employing long-term family assistance recipients	Individuals who begin work for the employer after December 31, 1997

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
52(c)	1601(b)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle B	Individuals who begin work for the employer after September 30, 1996
55(b)(1)(A)	311(b)(2)(A)	Maximum capital gains rate for individuals—minimum tax	Tax years ending after May 6, 1997
55(b)(3)	311(b)(1)	Maximum capital gains rate for individuals—minimum tax	Tax years ending after May 6, 1997
55(c)(1)	1601(f)(1)(C)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	Tax years beginning after December 31, 1995, generally
55(e)	401	Exemption from alternative minimum tax for small corporations	Tax years beginning after December 31, 1997
56(a)(1)(A)	402(a)	Repeal of separate depreciation lives for minimum tax purposes	Property placed in service after December 31, 1998
56(a)(5)	402(b)	Repeal of separate depreciation lives for minimum tax purposes	Property placed in service after December 31, 1998
56(a)(6)-(8)	403	Minimum tax not to apply to farmers' installment sales	Dispositions in tax years beginning after December 31, 1987, generally
56(e)(1)(A)	312(d)(1)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
56(e)(3)(B)	312(d)(1)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
56(g)(4)(B)	1212	Minimum tax treatment of certain property and casualty insurance companies	Tax years beginning after December 31, 1997
57(a)(7)	311(b)(2)(B)	Maximum capital gains rate for individuals—minimum tax	Tax years ending after May 6, 1997
59(a)(2)(C)	1057	Repeal of exception to alternative minimum foreign tax credit limit	Tax years beginning after date of enactment
59(a)(3)	1103	Election to use simplified section 904 limitation for alternative minimum tax	Tax years beginning after December 31, 1997
59(j)	1201(b)(1)	Minimum tax exemption amount for certain dependents	Tax years beginning after December 31, 1997
62(a)(2)(C)	975	Deduction in computing adjusted gross income for expenses in connection with service performed by certain officials	Expenses paid or incurred in tax years beginning after December 31, 1986

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
62(a)(17)	202(b)	Deduction for interest on education loans—deduction allowed whether or not taxpayer itemizes other deductions	Any qualified education loan incurred on, before, or after date of enactment, generally
63(c)(4), (5)	1201(a)	Basic standard deduction amount for certain dependents	Tax years beginning after December 31, 1997
72(d)(1)(B)	1075	Basis recovery rules for annuities over more than one life	Annuity starting dates beginning after December 31, 1997
72(t)(2)(E)	203(a)	Penalty-free withdrawals from individual retirement plans for higher education expenses	Distributions after December 31, 1997, with respect to expenses paid after such date (in tax years ending after such date), for education furnished in academic periods beginning after such date
72(t)(2)(F)	303(a)	Distributions from certain plans may be used without penalty to purchase first homes	Payments and distributions in tax years beginning after December 31, 1997
72(t)(7)	203(b)	Penalty-free withdrawals from individual retirement plans for higher education expenses—definition	Distributions after December 31, 1997, with respect to expenses paid after such date (in tax years ending after such date), for education furnished in academic periods beginning after such date
72(t)(8)	303(b)	Distributions from certain plans may be used without penalty to purchase first homes—definitions	Payments and distributions in tax years beginning after December 31, 1997
101(a)(2)	1084(b)(2)	Expansion of denial of deduction for certain amounts paid in connection with insurance—interest on policy loans	Contracts issued after June 8, 1997, in tax years ending after such date
101(h)	1528	Survivor benefits for public safety officers killed in the line of duty	Amounts received in tax years beginning after December 31, 1996, with respect to individuals dying after such date

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
108(f)(2)(B)-(D)	225(a)(1)	Treatment of cancellation of certain student loans—certain loans by exempt organizations	Discharges of indebtedness after date of enactment
108(f)(3)	225(a)(2)	Treatment of cancellation of certain student loans—certain loans by exempt organizations	Discharges of indebtedness after date of enactment
110	1213(a)	Qualified lessee construction allowances for short-term leases	Leases entered into after date of enactment
121	312(a)	Exemption from tax for gain on sale of principal residence	Sales and exchanges after May 6, 1997, generally
127(d)	221(a)	Extension of exclusion for employer-provided educational assistance	Tax years beginning after December 31, 1996
130(c)	962	Assignment of workmen's compensation liability eligible for exclusion relating to personal injury liability assignments	Claims under workmen's compensation acts filed after date of enactment
132(e)(2)	970	Clarification of de minimis fringe benefit rules to no-charge employee meals	Tax years beginning after December 31, 1997
132(f)(4)	1072	Election to receive taxable cash compensation in lieu of nontaxable parking benefits	Tax years beginning after December 31, 1997
135(c)(2)(C)	211(c)	Modifications of qualified state tuition programs—coordination with education savings bond	Tax years beginning after December 31, 1997, generally
135(c)(2)(C)	213(e)(2)	Education individual retirement accounts—technical amendments	Tax years beginning after December 31, 1997
135(d)(2)-(4)	201(d)	Hope and lifetime learning credits—coordination with section 135	Expenses paid after December 31, 1997 (in tax years ending after such date), for education furnished in academic periods beginning after such date, generally
137(b)(1)	1601(h)(2)(C)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle H	Tax years beginning after December 31, 1996
143(i)(1)(C)	312(d)(1)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
143(k)(11)	914	Mortgage financing for residences located in disaster areas	Date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
143(m)(6)(A)	312(d)(3)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
145(b)(5)	222	Repeal of limitation on qualified 501(c)(3) bonds other than hospital bonds	Date of enactment
148(c)(2)(B)-(E)	1444(a)	Repeal of expired provisions	Bonds issued after date of enactment
148(d)(3)	1443	Repeal of debt service-based limitation on investment in certain nonpurpose investments	Bonds issued after date of enactment
148(f)(4)(B)	1441	Repeal of $100,000 limitation on unspent proceeds under 1-year exception from rebate	Bonds issued after date of enactment
148(f)(4)(C)	1442	Exception from rebate for earnings on bona fide debt service fund under construction bond rules	Bonds issued after date of enactment
148(f)(4)(D)	223	Increase in arbitrage rebate exception for governmental bonds used to finance education facilities	Bonds issued after December 31, 1997
148(f)(4)(E)	1444(b)	Repeal of expired provisions	Bonds issued after date of enactment
162(a)	1204	Treatment of traveling expenses of certain federal employees engaged in criminal investigations	Amounts paid or incurred in tax years ending after date of enactment
162(l)(1)(B)	934	Increase in deduction for health insurance costs of self-employed individuals	Tax years beginning after December 31, 1996
162(l)(2)(B)	1602(c)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 323	Tax years beginning after December 31, 1996
162(o), (p)	1203(a)	Treatment of certain reimbursed expenses of rural mail carriers	Tax years beginning after December 31, 1997
163(h)(2)(E)	503(b)(2)(B)	Modifications to rate of interest on portion of estate tax extended under section 6166—disallowance of interest deduction	Estates of decedents dying after December 31, 1997
163(h)(4)(A)	312(d)(1)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
163(k), (l)	503(b)(2)(A)	Modifications to rate of interest on portion of estate tax extended under section 6166—disallowance of interest deduction	Estates of decedents dying after December 31, 1997
163(l)-(m)	1005	Denial of interest deductions on certain debt instruments	Disqualified debt instruments issued af-

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
			ter June 8, 1997, generally
165(i)(4)	912	Use of certain appraisals to establish amount of disaster loss	Date of enactment
167(g)(6)	1086(a)	Limitation of property for which income forecast method may be used	Property placed in service after date of enactment
168(e)(3)(A)	1086(b)(1)	Limitation of property for which income forecast method may be used—depreciation period for rent-to-own property	Property placed in service after date of enactment
168(g)(3)(B)	1086(b)(2)	Limitation of property for which income forecast method may be used—depreciation period for rent-to-own property	Property placed in service after date of enactment
168(i)(8)	1213(c)	Qualified lessee construction allowances for short-term leases—cross reference	Leases entered into after date of enactment
168(i)(14)	1086(b)(3)	Limitation of property for which income forecast method may be used—depreciation period for rent-to-own property	Property placed in service after date of enactment
168(j)(6)	1604(c)	Miscellaneous provisions—amendment related to Omnibus Budget Reconciliation Act of 1993	Property placed in service after December 31, 1993, generally
170(e)(5)(D)	602(a)	Contributions of stock to private foundations	Contributions made after May 31, 1997
170(e)(6)	224	Contributions of computer technology and equipment for elementary or secondary school purposes	Tax years beginning after December 31, 1997
170(h)(5)(B)	508(d)	Treatment of land subject to a qualified conservation easement—qualified conservation contribution where surface and mineral rights are separated	Easements granted after December 31, 1997
170(i)	973	Increase in standard mileage rate expense deduction for charitable use of passenger automobile	Tax years beginning after December 31, 1997
172(b)(1)(A), (F)	1082	Modification of tax years to which net operating losses may be carried	Net operating losses for tax years beginning after date of enactment
198	941	Expensing of environmental remediation costs	Expenditures paid or incurred after date of enactment, in tax years ending after such date
216(e)	312(d)(4)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
219(c)(1)(B)	301(c)	Establishment of nondeductible tax-free individual retirement accounts—spousal IRA	Tax years beginning after December 31, 1997
219(g)(1)	301(b)(1)	Restoration of IRA deduction for certain taxpayers—limitations for active participation not based on spouse's participation	Tax years beginning after December 31, 1997
219(g)(2)(A)	301(a)(2)	Restoration of IRA deduction for certain taxpayers—increase in income limits applicable to active participants	Tax years beginning after December 31, 1997
219(g)(3)(B)	301(a)(1)	Restoration of IRA deduction for certain taxpayers—increase in income limits applicable to active participants	Tax years beginning after December 31, 1997
219(g)(7)	301(b)(2)	Restoration of IRA deduction for certain taxpayers—limitations for active participation not based on spouse's participation	Tax years beginning after December 31, 1997
220(c)(3)(A)-(D)	1602(a)(2)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 301	Tax years beginning after December 31, 1996
220(d)(2)(C)	1602(a)(3)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 301	Tax years beginning after December 31, 1996
221	202(a)	Deduction for interest on education loans	Any qualified education loan incurred on, before, or after date of enactment, generally
246(c)(1)(A)	1015(a)	Modification of holding period applicable to dividends received deduction	Dividends received or accrued after the 30th day after date of enactment, generally
246(c)(2)	1015(b)(1)	Modification of holding period applicable to dividends received deduction—conforming amendment	Dividends received or accrued after the 30th day after date of enactment, generally
246(c)(3)(A)-(C)	1015(b)(2)	Modification of holding period applicable to dividends received deduction—conforming amendment	Dividends received or accrued after the 30th day after date of enactment, generally
263(a)(1)(F)-(H)	1604(a)(1)	Miscellaneous provisions—amendments related to Energy Policy Act of 1992	Property placed in service after June 30, 1993

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
264(a)(1)	1084(a)(1)	Expansion of denial of deduction for certain amounts paid in connection with insurance	Contracts issued after June 8, 1997, in tax years ending after such date
264(a)(4)	1084(b)(1)	Expansion of denial of deduction for certain amounts paid in connection with insurance—interest on policy loans	Contracts issued after June 8, 1997, in tax years ending after such date
264(a)(4)(A), (B)	1602(f)(1)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 501	Interest paid or accrued after October 13, 1995, generally
264(b)-(e)	1084(a)(2)	Expansion of denial of deduction for certain amounts paid in connection with insurance—exceptions	Contracts issued after June 8, 1997, in tax years ending after such date
264(d)(2)(B)	1602(f)(2)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 501	Interest paid or accrued after October 13, 1995, generally
264(d)(4)(B)	1602(f)(3)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 501	Interest paid or accrued after October 13, 1995, generally
264(f)	1084(c)	Expansion of denial of deduction for certain amounts paid in connection with insurance—pro rata allocation of interest expense to policy cash values	Contracts issued after June 8, 1997, in tax years ending after such date
265(b)(4)(A)	1084(c)	Expansion of denial of deduction for certain amounts paid in connection with insurance—conforming amendment	Contracts issued after June 8, 1997, in tax years ending after such date
267(b)(11)-(13)	1308(a)	Executor of estate and beneficiaries treated as related persons for disallowance of losses, etc.	Tax years beginning after date of enactment
267(f)(4)	1604(e)	Miscellaneous provisions—amendment related to Tax Reform Act of 1984	Transactions after December 31, 1983, in tax years ending after such date, generally
274(n)(3)	969	Increased deductibility of business meal expenses for individuals subject to federal hours of service	Tax years beginning after December 31, 1997
280A(c)(1)	932	Clarification of treatment of home office use for administrative and management activities	Tax years beginning after December 31, 1998
280A(d)(4)(A)	312(d)(1)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
280F(a)(1)(C)	971	Exemption of the incremental cost of a clean fuel vehicle from the limits on depreciation for vehicles	Property placed in service after date of enactment and before January 1, 2005
304(a)(1)	1013(a)	Tax treatment of redemptions involving related corporations—stock purchases by related corporations	Distributions and acquisitions after June 8, 1997, generally
304(b)(5)	1013(c)	Tax treatment of redemptions involving related corporations—special rule for acquisitions by foreign corporations	Distributions and acquisitions after June 8, 1997, generally
312(k)(3)(B)	1604(a)(2)	Miscellaneous provisions—amendments related to Energy Policy Act of 1992	Property placed in service after June 30, 1993
318(b)(8)	1142(e)(3)	Controlled foreign partnerships subject to information reporting comparable to information reporting for controlled foreign corporations—technical amendment	Annual accounting periods of foreign partnerships beginning after date of enactment
351(c)	1012(c)(1)	Application of section 355 to distributions in connection with acquisitions and to intragroup transactions—determination of control in certain divisive transactions	Transfers after date of enactment, generally
351(e)(1)	1002	Limitation on exception for investment companies under section 351	Transfers after June 8, 1997, in tax years ending after such date, generally
351(g), (h)	1014(a)	Certain preferred stock treated as boot—section 351	Transactions after June 8, 1997, generally
354(a)(2)(B)	1014(e)(1)	Certain preferred stock treated as boot—conforming amendment	Transactions after June 8, 1997, generally
354(a)(2)(C)	1014(b)	Certain preferred stock treated as boot—section 354	Transactions after June 8, 1997, generally
354(a)(3)(A)	1014(e)(2)	Certain preferred stock treated as boot—conforming amendment	Transactions after June 8, 1997, generally
355(a)(3)(C)	1014(e)(1)	Certain preferred stock treated as boot—conforming amendment	Transactions after June 8, 1997, generally
355(a)(3)(D)	1014(c)	Certain preferred stock treated as boot—section 355	Transactions after June 8, 1997, generally
355(a)(4)(A)	1014(e)(2)	Certain preferred stock treated as boot—conforming amendment	Transactions after June 8, 1997, generally
355(e)	1012(a)	Application of section 355 to distributions in connection with acquisitions and to intragroup transactions	Distributions after April 16, 1997, generally

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
355(f)	1012(b)(1)	Application of section 355 to distributions in connection with acquisitions and to intragroup transactions—special rules for certain intragroup transactions	Distributions after April 16, 1997, generally
356(e)-(g)	1014(d)	Certain preferred stock treated as boot—section 356	Transactions after June 8, 1997, generally
358	1012(b)(2)	Application of section 355 to distributions in connection with acquisitions and to intragroup transactions—special rules for certain intragroup transactions	Distributions after April 16, 1997, generally
367(d)(2)(C)	1131(b)(4)	Anti-avoidance provisions replacing repealed excise tax on transfers to foreign entities	Date of enactment
367(d)(3)	1131(b)(5)(A)	Anti-avoidance provisions replacing repealed excise tax on transfers to foreign entities	Date of enactment
367(f)	1131(b)(2)	Anti-avoidance provisions replacing repealed excise tax on transfers to foreign entities	Date of enactment
368(a)(2)(H)	1012(c)(2)	Application of section 355 to distributions in connection with acquisitions and to intragroup transactions—determination of control in certain divisive transactions	Transfers after date of enactment, generally
401(a)(1)	1530(c)(1)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
401(a)(5)(G)	1505(a)(1)	Extension of moratorium on application of certain nondiscrimination rules to state and local governments—nondiscrimination requirements	Tax years beginning on or after date of enactment, generally
401(a)(13)(C), (D)	1502(b)	Modification of prohibition of assignment or alienation	Judgments, orders, and decrees issued, and settlement agreements entered into, on or after date of enactment
401(a)(26)(H)	1505(a)(2)	Extension of moratorium on application of certain nondiscrimination rules to state and local governments—additional participation requirements	Tax years beginning on or after date of enactment, generally

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
401(k)(3)(G)	1505(b)	Extension of moratorium on application of certain nondiscrimination rules to state and local governments—participation and discrimination standards for qualified cash or deferred arrangements	Tax years beginning on or after date of enactment, generally
401(k)(7)(B)	1525	Section 401(k) plans for certain irrigation and drainage entities	Years beginning after December 31, 1997
401(k)(11)(B)	1601(d)(2)(D)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle D	Calendar years beginning after date of enactment
401(k)(11)(D)	1601(d)(2)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle D	Plan years beginning after December 31, 1996
401(k)(11)(E)	1601(d)(2)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle D	Plan years beginning after December 31, 1996
401(m)(11)	1601(d)(3)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle D	Years beginning after December 31, 1998
402(g)(9)	1501(a)	Matching contributions of self-employed individuals not treated as elective employer contributions	Years beginning after December 31, 1997
403(b)(1)(A)	1601(d)(6)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle D	Years beginning after December 31, 1996
403(b)(3)	1504(a)	Modification of 403(b) exclusion allowance to conform to 415 modifications—definition of compensation	Years beginning after December 31, 1997
403(b)(12)(C)	1505(c)	Extension of moratorium on application of certain nondiscrimination rules to state and local governments—nondiscrimination rules for section 403(b) plans	Tax years beginning on or after date of enactment, generally
404(a)(3)(A)	1601(d)(2)(C)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle D	Plan years beginning after December 31, 1996
404(a)(9)(C)	1530(c)(2)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
408(i)	301(d)	Establishment of nondeductible tax-free individual retirement accounts—authority to prescribe necessary reporting	Tax years beginning after December 31, 1997
408(i)	1601(d)(1)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle D	Tax years beginning after December 31, 1996
408(k)(6)(H)	1601(d)(1)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle D	Tax years beginning after December 31, 1996
408(l)(2)(B)	1601(d)(1)(C)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle D	Tax years beginning after December 31, 1996
408(m)(3)	304	Certain bullion not treated as collectibles	Tax years beginning after December 31, 1997
408(p)(2)(D)	1601(d)(1)(E), (F)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle D	Tax years beginning after December 31, 1996
408(p)(5)	1601(d)(1)(G)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle D	Tax years beginning after December 31, 1996
408(p)(8)	1501(b)	Matching contributions of self-employed individuals not treated as elective employer contributions—conforming amendment for SIMPLE retirement accounts	Years beginning after December 31, 1996
408(p)(8)	1601(d)(1)(D)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle D	Tax years beginning after December 31, 1996
408A	302(a)	Establishment of nondeductible tax-free individual retirement accounts	Tax years beginning after December 31, 1997
409(h)(2)	1506(a)	Clarification of certain rules relating to employee stock ownership plans of S corporations—certain cash distributions permitted	Tax years beginning after December 31, 1997
410(c)(2)	1505(a)(3)	Extension of moratorium on application of certain nondiscrimination rules to state and local governments—minimum participation standards	Tax years beginning on or after date of enactment, generally

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
411(a)(7)(B)	1071(a)(2)	Pension accrued benefit distributable without consent increased to $5,000—conforming amendment	Plan years beginning after date of enactment
411(a)(11)(A)	1071(a)(1)	Pension accrued benefit distributable without consent increased to $5,000	Plan years beginning after date of enactment
412(b)(2)(C)-(E)	1521(c)(1)	Increase in current liability funding limit—special amortization rule	Plan years beginning after December 31, 1998
412(c)(7)	1521(a)	Increase in current liability funding limit—amendment to 1986 code	Plan years beginning after December 31, 1998
412(c)(7)(D)	1521(c)(3)(A)	Increase in current liability funding limit—conforming amendment	Plan years beginning after December 31, 1998
412(m)(5)(E)	1604(b)(2)(A)	Miscellaneous provisions—amendments related to Uruguay Round Agreements Act	Plan years beginning after December 31, 1994
414(e)(5)(A)	1601(d)(6)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle D	Years beginning after December 31, 1996
414(e)(5)(C), (E)	1522	Special rules for church plans	Years beginning after December 31, 1997
414(n)(3)(C)	1601(h)(2)(D)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle H	Tax years beginning after December 31, 1996
414(q)(7), (9)	1601(d)(7)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle D	Years beginning after December 31, 1996
414(t)(2)	1601(h)(2)(D)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle H	Tax years beginning after December 31, 1996
415(b)(2)(G)	1527	Removal of dollar limitation on benefit payments from a defined benefit plan maintained for certain police and fire employees	Years beginning after December 31, 1996
415(c)(6)	1530(c)(3)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
415(e)(6), (7)	1530(c)(4)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
			after date of enactment
415(k)(3)	1526(b)	Portability of permissive service credit under governmental pension plans—special rule for repayment of cashouts	Permissive service credit contributions made in years beginning after December 31, 1997, generally
415(n)	1526(a)	Portability of permissive service credit under governmental pension plans	Permissive service credit contributions made in years beginning after December 31, 1997, generally
417(e)(1), (2)	1071(a)(2)	Pension accrued benefit distributable without consent increased to $5,000—conforming amendment	Plan years beginning after date of enactment
447(i)(3)-(6)	1081	Termination of suspense accounts for family corporations required to use accrual method of accounting	Tax years ending after June 8, 1997
451(e)	913(a)	Treatment of livestock sold on account of weather-related conditions—deferral of income inclusion	Sales and exchanges after December 31, 1996
457(e)(9)	1071(a)(2)	Pension accrued benefit distributable without consent increased to $5,000—conforming amendment	Plan years beginning after date of enactment
460(b)(2)(C)	1211(b)(1)	Modifications to look-back method for long-term contracts—modification of interest rate	For purposes of Code Sec. 167(g), property placed in service after September 13, 1995
460(b)(6)	1211(a)	Modifications to look-back method for long-term contracts	Contracts completed in tax years ending after date of enactment, generally
460(b)(7)	1211(b)(2)	Modifications to look-back method for long-term contracts—modification of interest rate	For purposes of Code Sec. 167(g), property placed in service after September 13, 1995
464(f)(3)(B)	312(d)(1)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
471(b), (c)	961	Use of estimates of shrinkage for inventory accounting	Tax years ending after date of enactment, generally
475(e)-(g)	1001(b)	Constructive sales treatment for appreciated financial positions—election of mark to market for dealers in commodities and for	Tax years ending after date of enactment, generally

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
		traders in securities or commodities	
501(c)(26)	101(c)	Child tax credit—high risk pools permitted to cover spouses and dependents of high risk individuals	Tax years beginning after December 31, 1997
501(c)(27)(B)	963(a)	Tax-exempt status for certain state worker's compensation act companies	Tax years beginning after December 31, 1997
501(c)(27)(A)-(C)	963(b)	Tax-exempt status for certain state worker's compensation act companies—conforming amendment	Tax years beginning after December 31, 1997
501(e)(1)(A)	974	Clarification of treatment of certain receivables purchased by cooperative hospital service organizations	Tax years beginning after December 31, 1996
512(a)(3)(D)	312(d)(5)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
512(b)(13)	1041	Expansion of look-thru rule for interest, annuities, royalties, and rents derived by subsidiaries of tax-exempt organizations	Tax years beginning after date of enactment, generally
512(e)(1)	1601(c)(4)(D)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle C	Tax years beginning after December 31, 1997
512(e)(2)	1601(c)(4)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle C	Tax years beginning after December 31, 1997
512(e)(3)	1523	Repeal of application of unrelated business income tax to ESOPs	Tax years beginning after December 31, 1997
513(i)	965	Exclusion from unrelated business taxable income for certain sponsorship payments	Payments solicited or received after December 31, 1997
528(b)	966(d)	Associations of holders of timeshare interests to be taxed like other homeowners associations—rate of tax	Tax years beginning after December 31, 1996
528(c)(1)	966(a)(1)	Associations of holders of timeshare interests to be taxed like other homeowners associations—timeshare associations included as homeowner associations	Tax years beginning after December 31, 1996
528(c)(4), (5)	966(a)(2)	Associations of holders of timeshare interests to be taxed like other homeowners associations—timeshare associations included as homeowner	Tax years beginning after December 31, 1996

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
528(c)(5)	966(c)	Associations of holders of timeshare interests to be taxed like other homeowners associations—association property	Tax years beginning after December 31, 1996
528(d)(3)(A)-(C)	966(b)	Associations of holders of timeshare interests to be taxed like other homeowners associations—exempt function income	Tax years beginning after December 31, 1996
529(b)(5)	211(b)(4)	Modifications of qualified state tuition programs—prohibition against investment direction	January 1, 1998, generally
529(c)(2), (5)	211(b)(3)(A)	Modifications of qualified state tuition programs—gift tax treatment	Transfers (including designations of new beneficiaries) made after date of enactment, generally
529(c)(3)(A)	211(d)	Modifications of qualified state tuition programs—clarification of taxation of distributions	January 1, 1998, generally
529(c)(4)	211(b)(3)(B)	Modifications of qualified state tuition programs—estate tax treatment	Estates of decedents dying after June 8, 1997, generally
529(d)	211(e)(2)(A)	Modifications of qualified state tuition programs—technical amendments	January 1, 1998, generally
529(e)(1)(B)	1601(h)(1)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle H	Tax years ending after August 20, 1996, generally
529(e)(1)(C)	1601(h)(1)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle H	Tax years ending after August 20, 1996, generally
529(e)(2)	211(b)(1)	Modifications of qualified state tuition programs—member of family	January 1, 1998, generally
529(e)(3)	211(a)	Modifications of qualified state tuition programs—qualified higher education expenses to include room and board	Tax years ending after August 20, 1996, generally
529(e)(5)	211(b)(2)	Modifications of qualified state tuition programs—eligible educational institution	Distributions after December 31, 1997, with respect to expenses paid after such date (in tax years ending after such date), for education furnished in academic periods beginning after such date, generally

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
530	213(a)	Education individual retirement accounts	Tax years beginning after December 31, 1997
532(b)(4)	1122(d)(1)	Election of mark to market for marketable stock in passive foreign investment company—conforming amendment	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
542(c)(10)	1122(d)(1)	Election of mark to market for marketable stock in passive foreign investment company—conforming amendment	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
551(f)	1122(d)(2)	Election of mark to market for marketable stock in passive foreign investment company—conforming amendment	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
593(e)(1)(A)	1601(f)(5)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	Tax years beginning after December 31, 1995
613A(c)(6)	972	Temporary suspension of taxable income limit on percentage depletion for marginal production	Tax years beginning after December 31, 1997
641(b)	1601(i)(3)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle I	Tax years beginning after December 31, 1996, generally
644	507(b)(1)	Repeal of throwback rules applicable to certain domestic trusts—repeal of tax on transfers to trusts at less than fair market value	Sales or exchanges after date of enactment
645	507(b)(1)	Repeal of throwback rules applicable to certain domestic trusts—repeal of tax on transfers to trusts at less than fair market value	Sales or exchanges after date of enactment
646	1305(a)	Certain revocable trusts treated as part of estate	Estates of decedents dying after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
663(b)	1306	Distributions during first 65 days of taxable year of estate	Tax years beginning after date of enactment
663(c)	1307	Separate share rules available to estates	Estates of decedents dying after date of enactment
664(d)(1)(A)	1089(a)	Limitations on charitable remainder trust eligibility for certain trusts—limitation on noncharitable distributions	Transfers in trust after June 18, 1997
664(d)(1)(B)-(D)	1089(b)(1)	Limitations on charitable remainder trust eligibility for certain trusts—charitable remainder annuity trusts	Transfers in trust after July 28, 1997, generally
664(d)(1)(B)	1530(c)(5)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
664(d)(1)(C)	1530(a)	Gratuitous transfers for the benefit of employees	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
664(d)(2)(A)	1089(a)	Limitations on charitable remainder trust eligibility for certain trusts—limitation on noncharitable distributions	Transfers in trust after June 18, 1997
664(d)(2)(B)-(D)	1089(b)(2)	Limitations on charitable remainder trust eligibility for certain trusts—charitable remainder unitrusts	Transfers in trust after July 28, 1997, generally
664(d)(2)(B)	1530(c)(5)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
664(d)(2)(C)	1530(a)	Gratuitous transfers for the benefit of employees	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
664(d)(4)	1089(b)(4)	Limitations on charitable remainder trust eligibility for certain trusts—severance of certain additional contributions	Transfers in trust after July 28, 1997, generally

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
664(g)	1530(b)	Gratuitous transfers for the benefit of employees—qualified gratuitous transfer defined	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
665(b)	507(a)(2)	Repeal of throwback rules applicable to certain domestic trusts—accumulation distributions	Distributions in tax years beginning after date of enactment
665(c)	507(a)(1)	Repeal of throwback rules applicable to certain domestic trusts—accumulation distributions	Distributions in tax years beginning after date of enactment
674(b)(4)	1530(c)(6)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
679(a)(3)(C)	1601(i)(2)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle I	Transfers of property after February 6, 1995
684	1131(b)	Recognition of gain on certain transfers to foreign trusts and estates	Date of enactment
685	1309	Treatment of funeral trusts	Tax years ending after date of enactment
691(c)(1)(C)	1073(b)(1)	Repeal of excess distribution and excess retirement accumulation tax—conforming amendment	Estates of decedents dying after December 31, 1996
704(c)(1)(B)	1063	Extension of time for taxing precontribution gain	Property contributed to a partnership after June 8, 1997, generally
706(b)(5)	507(b)(2)	Repeal of throwback rules applicable to certain domestic trusts—repeal of tax on transfers to trusts at less than fair market value	Sales or exchanges after date of enactment
706(c)(2)(A)	1246(a)	Closing of partnership taxable year with respect to deceased partner, etc.	Partnership tax years beginning after December 31, 1997
721(c)	1131(b)(3)	Anti-avoidance provisions replacing repealed excise tax on transfers to foreign entities	Date of enactment
721(d)	1131(b)(5)(B)	Anti-avoidance provisions replacing repealed excise tax on transfers to foreign entities	Date of enactment
724(d)(2)	1062(b)(3)	Repeal of requirement that inventory be substantially appreciated	Sales, exchanges, and distributions after

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
		with respect to sale or exchange of partnership interest—conforming amendment	date of enactment, generally
731(a)(2)(B)	1062(b)(3)	Repeal of requirement that inventory be substantially appreciated with respect to sale or exchange of partnership interest—conforming amendment	Sales, exchanges, and distributions after date of enactment, generally
731(c)(6)	1062(b)(3)	Repeal of requirement that inventory be substantially appreciated with respect to sale or exchange of partnership interest—conforming amendment	Sales, exchanges, and distributions after date of enactment, generally
732(c)	1061	Allocation of basis among properties distributed by partnership	Distributions after date of enactment
732(c)(1)(A)	1062(b)(3)	Repeal of requirement that inventory be substantially appreciated with respect to sale or exchange of partnership interest—conforming amendment	Sales, exchanges, and distributions after date of enactment, generally
735(a)(2)	1062(b)(3)	Repeal of requirement that inventory be substantially appreciated with respect to sale or exchange of partnership interest—conforming amendment	Sales, exchanges, and distributions after date of enactment, generally
735(c)(1)	1062(b)(3)	Repeal of requirement that inventory be substantially appreciated with respect to sale or exchange of partnership interest—conforming amendment	Sales, exchanges, and distributions after date of enactment, generally
737(b)(1)	1063	Extension of time for taxing precontribution gain	Property contributed to a partnership after June 8, 1997, generally
751(a)(2)	1062(a)	Repeal of requirement that inventory be substantially appreciated with respect to sale or exchange of partnership interest	Sales, exchanges, and distributions after date of enactment, generally
751(b)(1)(A), (B)	1062(b)(1)(A)	Repeal of requirement that inventory be substantially appreciated with respect to sale or exchange of partnership interest—conforming amendment	Sales, exchanges, and distributions after date of enactment, generally
751(b)(3)	1062(b)(1)(B)	Repeal of requirement that inventory be substantially appreciated with respect to sale or exchange of partnership interest—conforming amendment	Sales, exchanges, and distributions after date of enactment, generally
751(d)	1062(b)(2)	Repeal of requirement that inventory be substantially appreciated	Sales, exchanges, and distributions after

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
		with respect to sale or exchange of partnership interest—conforming amendment	date of enactment, generally
771	1221(a)	Simplified flow-through for electing large partnerships	Partnership tax years beginning after December 31, 1997
772	1221(a)	Simplified flow-through for electing large partnerships	Partnership tax years beginning after December 31, 1997
773	1221(a)	Simplified flow-through for electing large partnerships	Partnership tax years beginning after December 31, 1997
774	1221(a)	Simplified flow-through for electing large partnerships	Partnership tax years beginning after December 31, 1997
775	1221(a)	Simplified flow-through for electing large partnerships	Partnership tax years beginning after December 31, 1997
776	1221(a)	Simplified flow-through for electing large partnerships	Partnership tax years beginning after December 31, 1997
777	1221(a)	Simplified flow-through for electing large partnerships	Partnership tax years beginning after December 31, 1997
805(a)(4)(C), (D)	1084(b)(1)(A), (B)	Expansion of denial of deduction for certain amounts paid in connection with insurance—treatment of insurance companies	Contracts issued after June 8, 1997, in tax years ending after such date
805(a)(4)(F)	1084(b)(1)(C)	Expansion of denial of deduction for certain amounts paid in connection with insurance—treatment of insurance companies	Contracts issued after June 8, 1997, in tax years ending after such date
807(a)(2)(B)	1084(b)(2)(A)	Expansion of denial of deduction for certain amounts paid in connection with insurance—treatment of insurance companies	Contracts issued after June 8, 1997, in tax years ending after such date
807(b)(1)(B)	1084(b)(2)(B)	Expansion of denial of deduction for certain amounts paid in connection with insurance—treatment of insurance companies	Contracts issued after June 8, 1997, in tax years ending after such date
812(d)(1)(B)-(D)	1084(b)(3)	Expansion of denial of deduction for certain amounts paid in connection with insurance—treatment of insurance companies	Contracts issued after June 8, 1997, in tax years ending after such date
814(h)	1131(c)(1)	Recognition of gain on certain transfers to foreign trusts and estates—technical and conforming amendment	Date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
817(h)(2)(A), (B)	1271(b)(8)	Repeal of 30-percent gross income limitation—technical amendments	Tax years beginning after date of enactment
832(b)(5)(B)	1084(b)(4)	Expansion of denial of deduction for certain amounts paid in connection with insurance—treatment of insurance companies	Contracts issued after June 8, 1997, in tax years ending after such date
833(b)(1)(A)	1604(d)(2)	Miscellaneous provisions—amendment related to Tax Reform Act of 1986	Tax years beginning after December 31, 1986, generally
851	1271(b)(1)-(7)	Repeal of 30-percent gross income limitation—technical amendments	Tax years beginning after date of enactment
851(b)(2)-(4)	1271(a)	Repeal of 30-percent gross income limitation	Tax years beginning after date of enactment
852(b)(3)(D)	1254(b)(2)	Credit for tax paid by REIT on retained capital gains—conforming amendment	Tax years beginning after date of enactment
852(b)(10)	1122(c)(2)	Election of mark to market for marketable stock in passive foreign investment company—treatment of mark-to-market gain under section 4982	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
852(c)	1122(c)(3)	Election of mark to market for marketable stock in passive foreign investment company—treatment of mark-to-market gain under section 4982	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
853(c)	1053(b)	Holding period requirement for certain foreign taxes—notice of withholding taxes paid by regulated investment company	Dividends paid or accrued more than 30 days after date of enactment
856(a)(6)	1251(b)(2)	Clarification of limitation on maximum number of shareholders—conforming amendment	Tax years beginning after date of enactment
856(c)(3)-(8)	1255(a)	Repeal of 30-percent gross income requirement	Tax years beginning after date of enactment
856(c)(5)(G)	1255(b)(1)	Repeal of 30-percent gross income requirement—conforming amendment	Tax years beginning after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
856(c)(5)(G)	1258	Payments under hedging instruments	Tax years beginning after date of enactment
856(d)(2)(C)	1252(a)	De minimus rule for tenant services income	Tax years beginning after date of enactment
856(d)(5)	1253	Attribution rules applicable to stock ownership	Tax years beginning after date of enactment
856(d)(7)	1252(b)	De minimus rule for tenant services income—impermissible tenant service income	Tax years beginning after date of enactment
856(e)(2)	1257(a)(1)	Treatment of foreclosure property—initial period	Tax years beginning after date of enactment
856(e)(3)	1257(a)(2)	Treatment of foreclosure property—extension	Tax years beginning after date of enactment
856(e)(4)	1257(c)	Treatment of foreclosure property—certain activities not to disqualify property	Tax years beginning after date of enactment
856(e)(5)	1257(b)	Treatment of foreclosure property—revocation of election	Tax years beginning after date of enactment
856(i)(2)	1262	Wholly owned subsidiaries	Tax years beginning after date of enactment
856(j)(4), (5)	1261(a)	Shared appreciation mortgages—bankruptcy safe harbor	Tax years beginning after date of enactment
856(j)(5)(A)	1261(b)	Shared appreciation mortgages—clarification of definition of shared appreciation provision	Tax years beginning after date of enactment
856(k)	1251(b)(1)	Clarification of limitation on maximum number of shareholders—compliance with closely held prohibition	Tax years beginning after date of enactment
857(a)(2), (3)	1251(a)(1)	Clarification of limitation on maximum number of shareholders—rules relating to determination of ownership	Tax years beginning after date of enactment
857(b)(3)(D), (E)	1254(a)	Credit for tax paid by REIT on retained capital gains	Tax years beginning after date of enactment
857(b)(5)	1255(b)(2)	Repeal of 30-percent gross income requirement—conforming amendment	Tax years beginning after date of enactment
857(b)(6)(C)	1255(b)(3)	Repeal of 30-percent gross income requirement—conforming amendment	Tax years beginning after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
857(b)(6)(C)	1260	Prohibited transaction safe harbor	Tax years beginning after date of enactment
857(b)(7)(A)	1254(b)(1)	Credit for tax paid by REIT on retained capital gains—conforming amendment	Tax years beginning after date of enactment
857(d)(3)	1256	Modification of earnings and profits rules for determining whether REIT has earnings and profits from non-REIT year	Tax years beginning after date of enactment
857(e)(2)(B)-(D)	1259	Excess noncash income	Tax years beginning after date of enactment
857(f), (g)	1251(a)(2)	Clarification of limitation on maximum number of shareholders—rules relating to determination of ownership	Tax years beginning after date of enactment
860L(b)(1)(A)	1601(f)(6)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	September 1, 1997
860L(d)(2)	1601(f)(6)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	September 1, 1997
860L(e)(2)(A)	1601(f)(6)(E)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	September 1, 1997
860L(e)(2)(B)	1601(f)(6)(C)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	September 1, 1997
860L(e)(3)(A)	1601(f)(6)(D)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	September 1, 1997
860L(e)(3)(D)	1601(f)(6)(E)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	September 1, 1997
861(a)(3)	1174(a)(1)	Treatment of nonresident aliens engaged in international transportation services—sourcing rules	Remuneration for services performed in tax years beginning after December 31, 1997
863(c)(2)(B)	1174(a)(2)	Treatment of nonresident aliens engaged in international transporta-	Remuneration for services performed in

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
		tion services—transportation income	tax years beginning after December 31, 1997
864(b)(2)(A)	1162	Repeal of stock and securities safe harbor requirement that principal office be outside the U.S.	Tax years beginning after December 31, 1997
877(d)(2)(B), (D)	1602(g)(1), (2)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 511	Individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995, generally
877(d)(3)	1602(g)(3)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 511	Individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995, generally
877(d)(4)(A)	1602(g)(4)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 511	Individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995, generally
877(e)(1)	1602(h)(3)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 512	Individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995, generally
894(c)	1054	Denial of treaty benefits for certain payments through hybrid entities	Date of enactment
901(k), (l)	1053(a)	Holding period requirement for certain foreign taxes	Dividends paid or accrued more than 30

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
			days after date of enactment
901(k)(4)	1142(e)(4)	Controlled foreign partnerships subject to information reporting comparable to information reporting for controlled foreign corporations—technical amendment	Annual accounting periods of foreign partnerships beginning after date of enactment
902(b)	1113(a)(1)	Indirect foreign tax credit allowed for certain lower tier companies—section 902 credit	Taxes of foreign corporations for tax years of such corporations beginning after date of enactment, generally
902(c)(2)(B)	1163(a)	Miscellaneous clarifications—attribution of deemed paid foreign taxes to prior distributions	Date of enactment
902(c)(3)	1113(a)(2)(C), (D)	Indirect foreign tax credit allowed for certain lower tier companies—conforming amendment	Taxes of foreign corporations for tax years of such corporations beginning after date of enactment, generally
902(c)(3)(B)	1113(a)(2)(A)	Indirect foreign tax credit allowed for certain lower tier companies—conforming amendment	Taxes of foreign corporations for tax years of such corporations beginning after date of enactment, generally
902(c)(4)(B)	1113(a)(2)(B)	Indirect foreign tax credit allowed for certain lower tier companies—conforming amendment	Taxes of foreign corporations for tax years of such corporations beginning after date of enactment, generally
904(b)(2)(C)	311(c)(3)	Maximum capital gains rate for individuals—other conforming amendments	Tax years ending after May 6, 1997
904(d)(1)(E)	1105(a)(1)	Foreign tax credit treatment of dividends from noncontrolled section 902 corporations—separate basket only to apply to pre-2003 earnings	Tax years beginning after December 31, 2002
904(d)(2)(C), (D)	1105(a)(3)	Foreign tax credit treatment of dividends from noncontrolled section 902 corporations—conforming amendments	Tax years beginning after December 31, 2002
904(d)(2)(C)	1163(b)	Miscellaneous clarifications—financial services income determined without regard to high-taxed income	Date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
904(d)(2)(E)	1105(a)(2)	Foreign tax credit treatment of dividends from noncontrolled section 902 corporations—aggregation of non-PFICS	Tax years beginning after December 31, 2002
904(d)(2)(E)	1111(b)	Gain on certain stock sales by controlled foreign corporations treated as dividends	Distributions after date of enactment
904(d)(4)-(6)	1105(b)	Foreign tax credit treatment of dividends from noncontrolled section 902 corporations—application of look-thru rules to dividends of noncontrolled section 902 corporations attributable to post-2002 earnings	Tax years beginning after December 31, 2002
904(j), (k)	1101	Certain individuals exempt from foreign tax credit limitation	Tax years beginning after December 31, 1997
905(c)	1102(a)(2)	Exchange rate used in translating foreign taxes—accrued taxes	Taxes relating to tax years beginning after December 31, 1997
911(b)(2)(A), (D)	1172	Adjustment of dollar limitation on section 911 exclusion	Tax years beginning after December 31, 1997
927(a)(2)(B)	1171	Treatment of computer software as FSC export property	Gross receipts attributable to periods after December 31, 1997, in tax years ending after such date
951(a)(2)	1112(a)	Miscellaneous modifications to Subpart F—section 1248 gain taken into account in determining pro rata share	Dispositions after date of enactment
952(b)	1112(c)	Miscellaneous modifications to Subpart F—clarification of treatment of branch tax exemptions or reductions	Tax years beginning after December 31, 1986
954(c)(1)(B), (F), (G)	1051(a)	Definition of foreign personal holding company income	Tax years beginning after date of enactment
954(c)(2)(C)	1051(b)	Definition of foreign personal holding company income—exception for dealers	Tax years beginning after date of enactment
954(e)(2)(A)-(C)	1175(b)	Exemption from foreign base company services income	First full tax year of a foreign corporation beginning after December 31, 1997, and before January 1, 1999, and to tax years of U.S. shareholders with or within which such

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
			tax year of such foreign corporation ends
954(h)	1175(a)	Exemption from foreign personal holding company income	First full tax year of a foreign corporation beginning after December 31, 1997, and before January 1, 1999, and to tax years of U.S. shareholders with or within which such tax year of such foreign corporation ends
956(b)(1)(A)	1601(e)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle E	Tax years of foreign corporations beginning after December 31, 1996, and tax years of U.S. shareholders within which or with which such tax years of foreign corporations end
956(c)(2)(H)-(J)	1173	U.S. property not to include certain assets acquired by dealers in ordinary course of trade or business	Tax years of foreign corporations beginning after December 31, 1997 and U.S. shareholders with or within which such tax years of foreign corporations end
960(a)(1)	1113(b)	Indirect foreign tax credit allowed for certain lower tier companies—section 960 credit	Taxes of foreign corporations for tax years of such corporations beginning after date of enactment, generally
961(c)	1112(b)	Miscellaneous modifications to Subpart F—basis adjustments in stock held by foreign corporation	Applicable for determining inclusions for tax years of U.S. shareholders beginning after December 31, 1997
964(e)	1111(a)	Gain on certain stock sales by controlled foreign corporations treated as dividends	Gain recognized on transactions occurring after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
986(a)(3), (4)	1102(b)(1)	Exchange rate used in translating foreign taxes—authority to use average rates	Taxes paid or accrued in tax years beginning after December 31, 1997
986(a)	1102(a)(1)	Exchange rate used in translating foreign taxes—accrued taxes	Taxes paid or accrued in tax years beginning after December 31, 1997
988(e)	1104	Treatment of personal transactions by individuals under foreign currency rules	Tax years beginning after December 31, 1997
989(b)	1102(b)(3)	Exchange rate used in translating foreign taxes—authority to use average rates	Taxes paid or accrued in tax years beginning after December 31, 1997
989(c)(4)-(6)	1102(b)(2)	Exchange rate used in translating foreign taxes—authority to use average rates	Taxes paid or accrued in tax years beginning after December 31, 1997
1012(c)(4)(A), (B)	1042(a)	Termination of certain exceptions from rules relating to exempt organizations which provide commercial-type insurance	Tax years beginning after December 31, 1997
1014(a)(1)-(4)	508(b)	Treatment of land subject to a qualified conservation easement—carryover basis	Estates of decedents dying after December 31, 1997
1016(a)(7)	312(d)(6)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
1016(a)(23)	313(b)(1)	Rollover of gain from sale of qualified stock—conforming amendments	Sales after date of enactment
1016(a)(25)-(27)	701(b)(2)	Tax incentives for revitalization of the District of Columbia—conforming amendments	Date of enactment
1031(h)	1052	Personal property used predominantly in the U.S. treated as not property of a like kind with respect to property used predominantly outside the U.S.	Transfers after June 8, 1997, in tax years ending after such date, generally
1033(e)	913(b)	Treatment of livestock sold on account of weather-related conditions—involuntary conversions	Sales and exchanges after December 31, 1996
1033(h)(4)	312(d)(1)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
1033(i)	1087	Expansion of requirement that involuntarily converted property be replaced with property acquired from an unrelated person	Involuntary conversions occurring after June 8, 1997

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
1033(k)(3)	312(d)(7)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
1034	312(b)	Exemption from tax for gain on sale of principal residence—repeal of nonrecognition of gain on rollover of principal residence	Sales and exchanges after May 6, 1997, generally
1035(c), (d)	1131(b)(1)	Anti-avoidance provisions replacing repealed excise tax on transfers to foreign entities	Date of enactment
1036(b), (c)	1014(e)(3)	Certain preferred stock treated as boot—conforming amendment	Transactions after June 8, 1997, generally
1038(e)	312(d)(8)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
1042(g)	968	Nonrecognition of gain on sale of stock to certain farmers' cooperatives	Sales after December 31, 1997
1045	313(a)	Rollover of gain from sale of qualified stock	Sales after date of enactment
1057	1131(c)(2)	Recognition of gain on certain transfers to foreign trusts and estates—technical and conforming amendment	Date of enactment
1059(a)(2)	1011(a)	Tax treatment of extraordinary dividends in excess of basis	Distributions after May 3, 1995, generally
1059(d)(1)	1011(c)	Tax treatment of certain extraordinary dividends—time for reduction	Distributions after May 3, 1995, generally
1059(d)(3)	1604(d)(1)	Miscellaneous provisions—amendment related to Tax Reform Act of 1986	Date of enactment
1059(e)(1)	1011(b)	Tax treatment of certain extraordinary dividends—treatment of redemptions where options involved	Distributions after May 3, 1995, generally
1059(e)(1)(A)	1013(b)	Tax treatment of redemptions involving related corporations—coordination with section 1059	Distributions and acquisitions after June 8, 1997, generally
1092(f)(2)	1271(b)(9)	Repeal of 30-percent gross income limitation—technical amendments	Tax years beginning after date of enactment
1201(a)(2)	314	Amount of net capital gain taken into account in computing alternative tax on capital gains for corporations not to exceed taxable income of the corporation	Tax years ending after December 31, 1997
1223(7)	312(d)(9)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
1223(15)-(16)	313(b)(2)	Rollover of gain from sale of qualified stock—conforming amendments	Sales after date of enactment
1233(h)	1003(b)	Gains and losses from certain terminations with respect to property—treatment of short sales of property which become substantially worthless	Property which becomes substantially worthless after date of enactment
1234A(1)	1003(a)	Gains and losses from certain terminations with respect to property—application of capital treatment to property other than personal property	Terminations more than 30 days after date of enactment
1239(b)(2), (3)	1308(b)	Executor of estate and beneficiaries treated as related persons for disallowance of losses, etc.—ordinary income from gain from sale of depreciable property	Tax years beginning after date of enactment
1245(a)(2)(C)	1604(a)(3)	Miscellaneous provisions—amendments related to Energy Policy Act of 1992	Property placed in service after June 30, 1993
1245(a)(3)(C)	1604(a)(3)	Miscellaneous provisions—amendments related to Energy Policy Act of 1992	Property placed in service after June 30, 1993
1250(d)(7)-(10)	312(d)(10)(A)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
1250(e)(3)	312(d)(10)(B)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
1259	1001(a)	Constructive sales treatment for appreciated financial positions	Constructive sales after June 8, 1997, generally
1271(b)	1003(c)	Gains and losses from certain terminations with respect to property—application of capital treatment, etc. to obligations issued by natural persons	Sales, exchanges, and retirements after date of enactment
1272(a)(6)(C)	1004	Determination of original issue discount where pooled debt obligations subject to acceleration	Tax years beginning after date of enactment, generally
1274(c)(3)(B)	312(d)(1)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
1291(a)(3)(A)	1122(b)(3)	Election of mark to market for marketable stock in passive foreign investment company—coordination with interest charge, etc.	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
			within such tax years of U.S. persons
1291(d)	1122(b)(2)	Election of mark to market for marketable stock in passive foreign investment company—coordination with interest charge, etc.	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
1291(d)(1)	1122(b)(1)	Election of mark to market for marketable stock in passive foreign investment company—coordination with interest charge, etc.	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
1293(a)(1)	1122(d)(3)	Election of mark to market for marketable stock in passive foreign investment company—conforming amendment	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
1293(d)	1122(d)(3)	Election of mark to market for marketable stock in passive foreign investment company—conforming amendment	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
1296	1122(a)	Election of mark to market for marketable stock in passive foreign investment company	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
1296(e)	1121	U.S. shareholders of controlled foreign corporations not subject to PFIC inclusion	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
1297	1122(a)	Election of mark to market for marketable stock in passive foreign investment company	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
1297(a)	1123(b)	Valuation of assets for passive foreign investment company determination—conforming amendments	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
1297(b)(3)	1122(d)(4)	Election of mark to market for marketable stock in passive foreign investment company—conforming amendment	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
1297(e)	1123(a)	Valuation of assets for passive foreign investment company determination	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
1298	1122(a)	Election of mark to market for marketable stock in passive foreign investment company	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
1298(b)(1)	1122(e)	Election of mark to market for marketable stock in passive foreign investment company—clarification of gain recognition election	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
1301	933	Averaging of farm income over 3 years	Tax years beginning after December 31, 1997, and before January 1, 2001

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
1361(b)(1)(B)	1601(c)(4)(C)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle C	Tax years beginning after December 31, 1997
1361(b)(3)(A)	1601(c)(3)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle C	Tax years beginning after December 31, 1996
1361(c)(7)	1601(c)(4)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle C	Tax years beginning after December 31, 1997
1361(e)(1)(B)	1601(c)(1)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle C	Tax years beginning after December 31, 1996
1374(d)(7)	1601(f)(5)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	Tax years beginning after December 31, 1995
1377(b)(1)-(2)	1601(c)(2)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle C	Determinations made after December 31, 1996
1377(b)(1)(B)	1601(c)(2)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle C	Determinations made after December 31, 1996
1391(b)(2)	951(a)	Additional empowerment zones	Date of enactment, generally
1391(c)	952(d)(2)	Designation of new empowerment zones—conforming amendments	Date of enactment, generally
1391(e), (f)	952(d)(1)	Designation of new empowerment zones—conforming amendments	Date of enactment, generally
1391(g)	952(a)	Designation of new empowerment zones	Date of enactment, generally
1392(d)	954	Modification to eligibility criteria for designation of future enterprise zones in Alaska or Hawaii	Date of enactment
1394(b)(2)	955(b)	Modifications to enterprise zone facility bond rules for all empowerment zones and enterprise communities—modifications relating to qualified zone property	Obligations issued after date of enactment
1394(b)(3)	955(a)	Modifications to enterprise zone facility bond rules for all empowerment zones and enterprise communities—modifications relating to enterprise zone business	Obligations issued after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
1394(f)	953	Volume cap not to apply to enterprise zone facility bonds with respect to new empowerment zones	Obligations issued after date of enactment
1396(b)	951(b)	Additional empowerment zones—special rules for application employment credit	Date of enactment, generally
1396(e)	952(b)	Designation of new empowerment zones—employment credit not to apply to new empowerment zones	Date of enactment, generally
1397A(c)	952(c)	Designation of new empowerment zones—increased expensing under section 179 not to apply to developable sites	Date of enactment, generally
1397B(b), (c)	956(a)(2)	Modifications to enterprise zone business definition for all empowerment zones and enterprise communities	Tax years beginning on or after date of enactment, generally
1397B(b)(2), (c)(1)	956(a)(1)	Modifications to enterprise zone business definition for all empowerment zones and enterprise communities	Tax years beginning on or after date of enactment, generally
1397B(d)(2)	956(a)(4)	Modifications to enterprise zone business definition for all empowerment zones and enterprise communities	Tax years beginning on or after date of enactment, generally
1397B(d)(3)	956(a)(5)	Modifications to enterprise zone business definition for all empowerment zones and enterprise communities	Tax years beginning on or after date of enactment, generally
1397B(b)(4), (c)(3)	956(a)(3)	Modifications to enterprise zone business definition for all empowerment zones and enterprise communities	Tax years beginning on or after date of enactment, generally
1397B(f)	956(a)(6)	Modifications to enterprise zone business definition for all empowerment zones and enterprise communities	Tax years beginning on or after date of enactment, generally
1397E	226	Incentives for education zones	Obligations issued after December 31, 1997
1400	701(a)	Tax incentives for revitalization of the District of Columbia	Date of enactment
1400A	701(a)	Tax incentives for revitalization of the District of Columbia	Date of enactment
1400B	701(a)	Tax incentives for revitalization of the District of Columbia	Date of enactment
1400C	701(a)	Tax incentives for revitalization of the District of Columbia	Date of enactment
1402(k)	922(a)	Clarification of exemption from self-employment tax for certain termi-	Payments after December 31, 1997

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
		nation payments received by former insurance salesmen	
1445(e)(1)	311(c)(1)	Maximum capital gains rate for individuals—other conforming amendments	Amounts paid after date of enactment
1491	1131(a)	Repeal of excise tax on transfers to foreign entities	Date of enactment
1492	1131(a)	Repeal of excise tax on transfers to foreign entities	Date of enactment
1494	1131(a)	Repeal of excise tax on transfers to foreign entities	Date of enactment
2001(c)(2)	501(a)(1)(D)	Increase in unified estate and gift tax credit—phaseout of graduated rates and unified credit	Estates of decedents dying, and gifts made, after December 31, 1997
2001(f)	506(a)	Gifts may not be revalued for estate tax purposes after expiration of statute of limitations	Gifts made after date of enactment
2010(a)	501(a)(1)(A)	Increase in unified estate and gift tax credit—estate tax credit	Estates of decedents dying, and gifts made, after December 31, 1997
2010(c)-(d)	501(a)(1)(B)	Increase in unified estate and gift tax credit—applicable credit amount	Estates of decedents dying, and gifts made, after December 31, 1997
2013(g)	1073(b)(2)	Repeal of excess distribution and excess retirement accumulation tax—conforming amendment	Estates of decedents dying after December 31, 1996
2031(c), (d)	508(a)	Estate tax with respect to land subject to a qualified conservation easement	Estates of decedents dying after December 31, 1997
2032A(a)(3)	501(b)	Cost-of-living adjustments relating to estate and gift tax provisions—alternate valuation of certain farm, etc., real property	Estates of decedents dying, and gifts made, after December 31, 1997
2032A(b)(5)(A)	504(b)	Extension of treatment of certain rents under section 2032A to lineal descendants—conforming amendment	Leases entered into after December 31, 1976
2032A(c)(7)(E)	504(a)	Extension of treatment of certain rents under section 2032A to lineal descendants	Leases entered into after December 31, 1976
2032A(c)(8)	508(c)	Treatment of land subject to a qualified conservation easement—qualified conservation contribution is not a disposition	Easements granted after December 31, 1997
2032A(d)(3)	1313	Opportunity to correct certain failures under section 2032A	Estates of decedents dying after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
2033A	502(a)	Family-owned business exclusion	Estates of decedents dying after December 31, 1997
2035	1310	Adjustments for gifts within 3 years of decedent's death	Estates of decedents dying after date of enactment
2053(c)(1)(B)	1073(b)(3)	Repeal of excess distribution and excess retirement accumulation tax—conforming amendment	Estates of decedents dying after December 31, 1996
2053(c)(1)(D)	503(b)(1)	Modifications to rate of interest on portion of estate tax extended under section 6166—disallowance of interest deduction	Estates of decedents dying after December 31, 1997, generally
2055(a)(3)-(5)	1530(c)(7)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
2055(e)(3)(G)	1089(b)(5)	Limitations on charitable remainder trust eligibility for certain trusts—conforming amendment	Transfers in trust after July 28, 1997, generally
2055(e)(3)(J)	1089(b)(3)	Limitations on charitable remainder trust eligibility for certain trusts—void or reformed trust	Transfers in trust after July 28, 1997, generally
2056(b)(7)(C)	1311	Clarification of treatment of survivor annuities under qualified terminable interest rules	Estates of decedents dying after date of enactment
2056(b)(8)	1530(c)(8)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
2056A(a)(1)(A)	1314	Authority to waive requirement of U.S. trustee for qualified domestic trusts	Estates of decedents dying after date of enactment
2056A(c)(3)	1312	Treatment under qualified domestic trust rules of forms of ownership which are not trusts	Estates of decedents dying after date of enactment
2102(c)(3)(A)	501(a)(1)(E)	Increase in unified estate and gift tax credit—estates of nonresidents not citizens	Estates of decedents dying, and gifts made, after December 31, 1997
2105(b)(2)-(4)	1304	Treatment for estate tax purposes of short-term obligations held by non-resident aliens	Estates of decedents dying after date of enactment
2107(c)(2)(B), (C)	1602(g)(6)	Amendments related to Health Insurance Portability and Accounta-	Individuals losing U.S. citizenship on or af-

Code Sec	Act Sec	Act Provision Subject	Effective Date
		bility Act of 1996—amendments related to section 511	ter February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995, generally
2207A(a)(2)	1302(a)	Clarification of waiver of certain rights of recovery	Estates of decedents dying after date of enactment
2207B(a)(2)	1302(b)	Clarification of waiver of certain rights of recovery	Estates of decedents dying after date of enactment
2501(a)(3)(C)	1602(g)(5)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 511	Individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995, generally
2503(b)	501(c)	Cost-of-living adjustments relating to estate and gift tax provisions—annual gift tax exclusion	Estates of decedents dying, and gifts made, after December 31, 1997
2504(c)	506(d)	Gifts may not be revalued for estate tax purposes after expiration of statute of limitations—conforming amendment	Date of enactment
2505(a)(1)	501(a)(2)	Increase in unified estate and gift tax credit—unified gift tax credit	Estates of decedents dying, and gifts made, after December 31, 1997
2612(c)(2)	511(b)(2)	Expansion of exception from generation-skipping transfer tax for transfers to individuals with deceased parents—conforming amendment	Terminations, distributions, and transfers occurring after December 31, 1997
2612(c)(2), (3)	511(b)(1)	Expansion of exception from generation-skipping transfer tax for transfers to individuals with deceased parents—conforming amendment	Terminations, distributions, and transfers occurring after December 31, 1997
2631(c)	501(d)	Cost-of-living adjustments relating to estate and gift tax provisions—exemption from generation-skipping tax	Estates of decedents dying, and gifts made, after December 31, 1997

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
2651(e), (f)	511(a)	Expansion of exception from generation-skipping transfer tax for transfers to individuals with deceased parents	Terminations, distributions, and transfers occurring after December 31, 1997
2652(b)(1)	1305(b)	Certain revocable trusts treated as part of estate—comparable treatment under generation-skipping tax	Estates of decedents dying after date of enactment
3301(1), (2)	1035	Extension of temporary unemployment tax	Date of enactment
4001(a)	906(a)	Exemption of electric and other clean-fuel motor vehicles from luxury automobile classification	Sales and installations occurring after date of enactment
4001(e)	906(b)(1)	Exemption of electric and other clean-fuel motor vehicles from luxury automobile classification—conforming amendment	Sales and installations occurring after date of enactment
4001(f)	906(b)(2)	Exemption of electric and other clean-fuel motor vehicles from luxury automobile classification—conforming amendment	Sales and installations occurring after date of enactment
4001(f)	1601(f)(3)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	Sales after date of enactment
4001(g)	1601(f)(3)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	Sales after date of enactment
4003(a)(1)(A)	906(b)(3)	Exemption of electric and other clean-fuel motor vehicles from luxury automobile classification—conforming amendment	Sales and installations occurring after date of enactment
4003(a)(2)(B)	906(b)(4)	Exemption of electric and other clean-fuel motor vehicles from luxury automobile classification—conforming amendment	Sales and installations occurring after date of enactment
4003(a)(3)(C)	1401	Increase in de minimis limit for after-market alterations for heavy trucks and luxury cars	Installations on vehicles sold after date of enactment
4041(a)(1)(A)	902(b)(1)	Repeal of tax on diesel fuel used in recreational boats—conforming amendment	January 1, 1998
4041(a)(1)(D)	902(b)(2)	Repeal of tax on diesel fuel used in recreational boats—conforming amendment	January 1, 1998
4041(a)(2)	907(a)(1)	Rate of tax on certain special fuels determined on basis of BTU equivalency with gasoline—special motor fuels	October 1, 1997

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
4041(a)(2)	1601(f)(4)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	August 27, 1996
4041(a)(2)	1032(e)(1)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998
4041(c)(1)	1032(e)(2)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998
4041(c)(2)	1435(b)	Skydiving flights exempt from tax on transportation of persons by air—transportation treated as noncommercial aviation	October 1, 1997
4041(c)(3)(B)	1031(a)(3)	Extension and modification of airport and airway trust fund taxes—fuel taxes	October 1, 1997
4041(d)(1)	907(a)(2)	Rate of tax on certain special fuels determined on basis of BTU equivalency with gasoline—special motor fuels	October 1, 1997
4041(l)	1601(f)(4)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	August 27, 1996
4041(m)(1)(A)	907(b)	Rate of tax on certain special fuels determined on basis of BTU equivalency with gasoline—methanol fuel produced from natural gas	October 1, 1997
4051(b)(2)(B)	1401	Increase in de minimis limit for after-market alterations for heavy trucks and luxury cars	Installations on vehicles sold after date of enactment
4051(d), (e)	1432(a)	Repeal of expired provisions—piggyback trailers	Date of enactment
4051(e)	1402(a)	Credit for tire tax in lieu of exclusion of value of tires in computing price	January 1, 1998
4052(b)(1)(B)	1402(b)	Credit for tire tax in lieu of exclusion of value of tires in computing price—conforming amendment	January 1, 1998
4052(d)	1434(b)(1)	Modifications to retail tax on heavy trucks—simplification of certification procedures with respect to sales of taxable articles	January 1, 1998
4052(e), (f)	1434(a)	Modifications to retail tax on heavy trucks—certain repairs and modifications not treated as manufacture	January 1, 1998
4052(g)	1434(b)(2)	Modifications to retail tax on heavy trucks—requirement to modify regulations	January 1, 1998

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
4081(a)(2)(A)	1032(b)	Kerosene taxed as diesel fuel—rate of tax	July 1, 1998
4081(d)(2)(B)	1031(a)(2)	Extension and modification of airport and airway trust fund taxes—fuel taxes	October 1, 1997
4081(d)(3)	1033	Restoration of leaking underground storage tank trust fund taxes	Date of enactment
4082	1032(e)(3)(A)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998
4082(a), (c), (d)	1032(c)(1)	Kerosene taxed as diesel fuel—exemptions from tax	July 1, 1998
4082(d)-(f)	1032(c)(2)	Kerosene taxed as diesel fuel—exemptions from tax	July 1, 1998
4083(a)(1)(A)-(C)	1032(a)	Kerosene taxed as diesel fuel	July 1, 1998
4083(a)(3)	902(b)(3)	Repeal of tax on diesel fuel used in recreational boats—conforming amendment	January 1, 1998
4083(b)	1032(e)(4)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998
4091(b)(3)(A)	1031(a)(1)	Extension and modification of airport and airway trust fund taxes—fuel taxes	October 1, 1997
4091(d)	1436(a)	Allowance or credit of refund for tax-paid aviation fuel purchased by registered producer of aviation fuel	Fuel acquired by the producer after September 30, 1997
4092(b)	1601(f)(4)(C)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	August 27, 1996
4093(a)	1032(e)(5)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998
4101(e)	1032(d)	Kerosene taxed as diesel fuel—certain approved terminals of registered persons required to offer dyed diesel fuel and kerosene for nontaxable purposes	July 1, 1998
4131(b)	904(a)	Uniform rate of tax on vaccines	Day after date of enactment
4132(a)(1)	904(b)	Uniform rate of tax on vaccines—taxable vaccines	Day after date of enactment
4132(a)(2)-(8)	904(c)	Uniform rate of tax on vaccines—conforming amendment	Day after date of enactment
4161(b)	1433	Simplification of imposition of excise tax on arrows	Articles sold by the manufacturer, producer, or importer after September 30, 1997

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
4222(b)(2)	1431	Authority to grant exemptions from registration requirements	Date of enactment
4251(d)	1034	Application of communications tax to prepaid telephone cards	Amendments paid in calendar months beginning more than 60 days after date of enactment
4261(a)-(c)	1031(c)(1)	Extension and modification of airport and airway trust fund taxes—transportation of persons by air	Transportation beginning on or after October 1, 1997, generally
4261(e)-(h)	1031(c)(2)	Extension and modification of airport and airway trust fund taxes—transportation of persons by air	Transportation beginning on or after October 1, 1997, generally
4261(g)	1601(f)(4)(D)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	August 27, 1996
4261(g)(1)(A)	1031(b)(1)	Extension and modification of airport and airway trust fund taxes—ticket taxes	Transportation beginning on or after October 1, 1997, generally
4261(h), (i)	1435(a)	Skydiving flights exempt from tax on transportation of persons by air	Amounts paid after September 30, 1997
4263(c)	1031(c)(3)	Extension and modification of airport and airway trust fund taxes—transportation of persons by air	Transportation beginning on or after October 1, 1997, generally
4271(d)(1)(A)	1031(b)(2)	Extension and modification of airport and airway trust fund taxes—ticket taxes	Transportation beginning on or after October 1, 1997, generally
4495	1432(b)	Repeal of expired provisions—deep seabed mining	Date of enactment
4496	1432(b)	Repeal of expired provisions—deep seabed mining	Date of enactment
4497	1432(b)	Repeal of expired provisions—deep seabed mining	Date of enactment
4498	1432(b)	Repeal of expired provisions—deep seabed mining	Date of enactment
4681(b)(1)(B), (C)	1432(c)(1)	Repeal of expired provisions—ozone-depleting chemicals	Date of enactment
4682(d)(1)	903(a)	Continued application of tax on imported recycled halon-1211	Date of enactment
4682(g)	1432(c)(2)	Repeal of expired provisions—ozone-depleting chemicals	Date of enactment
4947(b)(4)	1530(c)(9)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
			stock ownership plan after date of enactment
4962(b)	1603(a)	Amendments related to Taxpayer Bill of Rights 2—amendment related to section 1311	Excess benefit transactions occurring on or after September 14, 1995, generally
4972(c)(6)(B)	1507	Modification of 10-percent tax for nondeductible contributions	Tax years beginning after December 31, 1997
4973(a)(2)-(4)	213(d)(1)	Education individual retirement accounts—tax on excess contributions	Tax years beginning after December 31, 1997
4973(b), (f)	302(b)	Establishment of nondeductible tax-free individual retirement accounts—excess contributions	Tax years beginning after December 31, 1997
4973(e)	213(d)(2)	Education individual retirement accounts—tax on excess contributions	Tax years beginning after December 31, 1997
4975(a)	1074	Increase in tax on prohibited transactions	Prohibited transactions occurring after date of enactment
4975(c)(4)	1602(a)(5)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 321	Tax years beginning after December 31, 1996
4975(c)(5)	213(b)(2)	Education individual retirement accounts—tax on prohibited transactions	Tax years beginning after December 31, 1997
4975(d)	1506(b)(1)(B)	Clarification of certain rules relating to employee stock ownership plans of S corporations—certain shareholder-employees not treated as owner-employees	Tax years beginning after December 31, 1997
4975(e)(1)(D)-(F)	213(b)(1)	Education individual retirement accounts—tax on prohibited transactions	Tax years beginning after December 31, 1997
4975(e)(7)	1530(c)(10)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
4975(f)(6)	1506(b)(1)(A)	Clarification of certain rules relating to employee stock ownership plans of S corporations—certain shareholder-employees not treated as owner-employees	Tax years beginning after December 31, 1997

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
4978(a)	1530(c)(11)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
4978(b)(2)	1530(c)(12)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
4978(c)	1530(c)(13)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
4978(e)(2)	1530(c)(14)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
4979A(a)	1530(c)(15)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
4979A(c)	1530(c)(16)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
4979A(d), (e)	1530(c)(17)	Gratuitous transfers for the benefit of employees—conforming amendment	Transfers made by trusts to, or for the use of, an employee stock ownership plan after date of enactment
4980A	1073(a)	Repeal of excess distribution and excess retirement accumulation tax	Excess distributions received after December 31, 1996, generally
4980D(a)	1531(b)(2)(A)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and	Group health plans for plan years beginning on or after January 1, 1998

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
		the Mental Health Parity Act of 1996—conforming amendment	
4980D(c)(3)(B)	1531(b)(2)(B)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996—conforming amendment	Group health plans for plan years beginning on or after January 1, 1998
4980D(d)(1)	1531(b)(2)(C)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996—conforming amendment	Group health plans for plan years beginning on or after January 1, 1998
4980D(d)(3)	1531(b)(2)(D)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996—conforming amendment	Group health plans for plan years beginning on or after January 1, 1998
4980D(f)(1)	1531(b)(2)(E)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996—conforming amendment	Group health plans for plan years beginning on or after January 1, 1998
4982(e)(6)	1122(c)(1)	Election of mark to market for marketable stock in passive foreign investment company—treatment of mark-to-market gain under section 4982	Tax years of U.S. persons beginning after December 31, 1997 and tax years of foreign corporations ending with or within such tax years of U.S. persons
5008(c)(1)	1411	Credit or refund for imported bottled distilled spirits returned to distilled spirits plant	First day of first calendar quarter that begins at least 180 days after date of enactment
5041(b)(4)-(6)	908(a)	Modification of tax treatment of hard cider—hard cider containing less than 7 percent alcohol taxed as wine	October 1, 1997
5041(c)(1)	908(b)	Modification of tax treatment of hard cider—application of small producer credit	October 1, 1997
5044	1416(b)(2)	Refund of tax to wine returned to bond not limited to unmerchantable wine—conforming amendment	First day of first calendar quarter that begins at least 180 days after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
5044(a)	1416(a)	Refund of tax to wine returned to bond not limited to unmerchantable wine	First day of first calendar quarter that begins at least 180 days after date of enactment
5053(f), (i)	1414(b)	Fermented material from any brewery may be received at a distilled spirits plant—clarification of authority to permit removal of beer without payment of tax for use as distilling material	First day of first calendar quarter that begins at least 180 days after date of enactment
5053(g)	1418	Domestically produced beer may be withdrawn free of tax for use of foreign embassies, legations, etc.	First day of first calendar quarter that begins at least 180 days after date of enactment
5053(h)	1419	Beer may be withdrawn free of tax for destruction	First day of first calendar quarter that begins at least 180 days after date of enactment
5055	1420	Authority to allow drawback on exported beer without submission of records	First day of first calendar quarter that begins at least 180 days after date of enactment
5056(c), (d)	1414(c)	Fermented material from any brewery may be received at a distilled spirits plant—clarification of refund and credit of tax	First day of first calendar quarter that begins at least 180 days after date of enactment
5115	1415(a)	Repeal of requirement for wholesale dealers in liquors to post sign	Date of enactment
5175(c)	1412	Authority to cancel or credit export bonds without submission of records	First day of first calendar quarter that begins at least 180 days after date of enactment
5207(c)	1413	Repeal of required maintenance of records on premises of distilled spirits plant	First day of first calendar quarter that begins at least 180 days after date of enactment
5222(b)(2)	1414(a)	Fermented material from any brewery may be received at a distilled spirits plant	First day of first calendar quarter that begins at least 180 days after date of enactment
5361	1416(b)(1)	Refund of tax to wine returned to bond not limited to unmerchant-	First day of first calendar quarter that be-

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
		able wine—conforming amendment	gins at least 180 days after date of enactment
5364	1422	Transfer to bonded wine cellars of wine imported in bulk without payment of tax	First day of first calendar quarter that begins at least 180 days after date of enactment
5384(b)(2)(D)	1417	Use of additional ameliorating material in certain wines	First day of first calendar quarter that begins at least 180 days after date of enactment
5388	910	Clarification of authority to use semi-generic designations on wine labels	Date of enactment
5418	1421	Transfer to brewery of beer imported in bulk without payment of tax	First day of first calendar quarter that begins at least 180 days after date of enactment
5681(a), (c)	1415(b)	Repeal of requirement for wholesale dealers in liquors to post sign—conforming amendment	Date of enactment
6011(e)(2)	1224	Returns required on magnetic media	Partnership tax years ending on or after December 31, 1997
6012(b)(6)	1225	Treatment of partnership items of individual retirement accounts	Partnership tax years ending on or after December 31, 1997
6012(c)	312(d)(11)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
6018(a)(1)	501(a)(1)(C)	Increase in unified estate and gift tax credit—estate tax returns	Estates of decedents dying, and gifts made, after December 31, 1997
6018(a)(4)	1073(b)(4)	Repeal of excess distribution and excess retirement accumulation tax—conforming amendment	Estates of decedents dying after December 31, 1996
6019(1)-(3)	1301	Gifts to charities exempt from gift tax filing requirements	Gifts made after date of enactment
6031(b)	1223(a)	Due date for furnishing information to partners of electing large partnerships	Partnership tax years ending on or after December 31, 1997
6031(e)	1141(a)	Clarification of application of return requirement to foreign partnerships	Tax years beginning after date of enactment

Code Sec	Act Sec.	Act Provision Subject	Effective Date
6033(b)(10), (11)	1603(b)	Amendments related to Taxpayer Bill of Rights 2—amendment related to section 1312	Returns for tax years beginning after July 30, 1996
6034A(c)	1027(a)	Returns of beneficiaries of estates and trusts required to file returns consistent with estate or trust return or to notify secretary of inconsistency—domestic estates and trusts	Returns of beneficiaries and owners filed after date of enactment
6038	1142(e)(1)	Controlled foreign partnerships subject to information reporting comparable to information reporting for controlled foreign corporations—technical amendments	Annual accounting periods of foreign partnerships beginning after date of enactment
6038(a)(1)	1142(a)	Controlled foreign partnerships subject to information reporting comparable to information reporting for controlled foreign corporations	Annual accounting periods of foreign partnerships beginning after date of enactment
6038(a)(5)	1142(d)	Controlled foreign partnerships subject to information reporting comparable to information reporting for controlled foreign corporations—reporting by 10 percent partners	Annual accounting periods of foreign partnerships beginning after date of enactment
6038(b)	1142(c)(1)	Controlled foreign partnerships subject to information reporting comparable to information reporting for controlled foreign corporations—modification of sanctions on partnerships and corporations for failure to furnish information	Annual accounting periods of foreign partnerships beginning after date of enactment
6038(c)(1)(B)	1142(e)(2)	Controlled foreign partnerships subject to information reporting comparable to information reporting for controlled foreign corporations—technical amendment	Annual accounting periods of foreign partnerships beginning after date of enactment
6038(e)(1)-(4)	1142(b)	Controlled foreign partnerships subject to information reporting comparable to information reporting for controlled foreign corporations—definitions	Annual accounting periods of foreign partnerships beginning after date of enactment
6038B(a)(1)	1144(a)	Transfers of property to foreign partnerships subject to information reporting comparable to information reporting for such transfers to foreign corporations	Transfers made after date of enactment, generally
6038B(b), (c)	1144(b)	Transfers of property to foreign partnerships subject to information reporting comparable to information reporting for such	Transfers made after date of enactment, generally

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
		transfers to foreign corporations—exceptions	
6038B(b)(1), (3)	1144(c)	Transfers of property to foreign partnerships subject to information reporting comparable to information reporting for such transfers to foreign corporations—modification of applicable penalty	Transfers made after date of enactment, generally
6039D(d)(1)	1601(h)(2)(D)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle H	Tax years beginning after December 31, 1996
6039F	1602(h)(1)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 512	Individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995, generally
6039G	1602(h)(1)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 512	Individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995, generally
6041A(d)(3)	1022	Decrease of threshold for reporting payments to corporations performing services for federal agencies	Returns due, without regard to any extension, more than 90 days after date of enactment
6045(e)(5)	312(c)	Exemption from tax for gain on sale of principal residence—exception from reporting	Sales and exchanges after May 6, 1997, generally
6045(f)	1021	Reporting of certain payments made to attorneys	Payments made after December 31, 1997
6046(a)	1146	Increase in filing thresholds for returns as to organizations of foreign corporations and acquisitions of stock in such corporations	January 1, 1998
6046A(a)	1143(a)(1)	Modifications relating to returns required to be filed bý reason of changes in ownership interests in foreign partnership	Transfers and changes after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
6046A(d), (e)	1143(a)(2)	Modifications relating to returns required to be filed by reason of changes in ownership interests in foreign partnership	Transfers and changes after date of enactment
6048(b)	1601(i)(1)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle I	Tax years of U.S. persons beginning after December 31, 1995
6048(d)(5)	1027(b)	Returns of beneficiaries of estates and trusts required to file returns consistent with estate or trust return or to notify secretary of inconsistency—foreign trusts	Returns of beneficiaries and owners filed after date of enactment
6050Q(b)(1)	1602(d)(1)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 323	Benefits paid after December 31, 1996
6050R(c)(1)	1601(a)(1)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle A	Payments made after December 31, 1997
6050S	201(c)(1)	Hope and lifetime learning credits—returns relating to higher education tuition and related expenses	Expenses paid after December 31, 1997 (in tax years ending after such date), for education furnished in academic periods beginning after such date, generally
6050S(a)(2)	202(c)(1)	Deduction for interest on education loans—reporting requirement	Any qualified education loan incurred on, before, or after date of enactment, generally
6050S(b)(2)(A),(C)	202(c)(2)	Deduction for interest on education loans—reporting requirement	Any qualified education loan incurred on, before, or after date of enactment, generally
6050S(e)	202(c)(3)	Deduction for interest on education loans—reporting requirement	Any qualified education loan incurred on, before, or after date of enactment, generally
6103(d)(5)	976(c)	Combined employment tax reporting demonstration project	Date of enactment
6103(e)(1)(A)	1201(b)(2)	Minimum tax exemption amount for certain dependents	Tax years beginning after December 31, 1997

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
6103(h)(5), (6)	1283(a)	Repeal of authority to disclose whether prospective juror has been audited	Judicial proceedings commenced after date of enactment
6103(k)(8)	1026(a)	Confidentiality and disclosure of returns and return information	Levies issued after date of enactment
6103(k)(8)	1205(c)(1)	Payment of tax by commercially acceptable means—amendments to sections 6103 and 7431 with respect to disclosure authorization	Nine months after date of enactment
6103(l)(7)(D)	1023	Disclosure of return information for administration of certain veterans programs	Date of enactment
6103(p)(3)(A)	1026(b)(1)(A)	Confidentiality and disclosure of returns and return information—conforming amendment	Levies issued after date of enactment
6103(p)(3)(A)	1205(c)(3)	Payment of tax by commercially acceptable means—amendments to sections 6103 and 7431 with respect to disclosure authorization	Nine months after date of enactment
6103(p)(4)	1026(b)(1)(B)	Confidentiality and disclosure of returns and return information—conforming amendment	Levies issued after date of enactment
6103(p)(4)	1283(b)	Repeal of authority to disclose whether prospective juror has been audited—conforming amendment	Judicial proceedings commenced after date of enactment
6111(d)-(f)	1028(a)	Registration and other provisions relating to confidential corporate tax shelters	Any tax shelter interests offered to potential participants after Secretary of the Treasury prescribes guidance implementing the Act
6166(b)(7)(A), (8)(A)	503(c)(1)	Modifications to rate of interest on portion of estate tax extended under section 6166—conforming amendments	Estates of decedents dying after December 31, 1997
6211(c)	1231(b)	Treatment of partnership items in deficiency proceedings	Partnership tax years ending after date of enactment
6212(c)(2)(C)	312(d)(12)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
6213(g)(2)(G)-(I)	101(d)(2)	Child tax credit—conforming amendment	Tax years beginning after December 31, 1997
6213(g)(2)(H)-(J)	201(b)	Hope and lifetime learning credits—extension of procedures applicable to mathematical or clerical errors	Expenses paid after December 31, 1997 (in tax years ending

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
			after such date), for education furnished in academic periods beginning after such date, generally
6213(g)(2)(H)-(J)	1085(a)(3)	Restrictions on availability of earned income credit for taxpayers who improperly claimed credit in prior year—extension procedures applicable to mathematical or clerical errors	Tax years beginning after December 31, 1996
6221	1238(a)	Determination of penalties at partnership level	Partnership tax years ending after date of enactment
6225(b)	1239(a)	Tax court jurisdiction to enjoin premature assessments of deficiencies attributable to partnership items	Partnership tax years ending after date of enactment
6226(b)(5), (6)	1240	Treatment of premature petitions filed by notice partners or 5-percent groups	Petitions filed after date of enactment
6226(d)(1)	1239(b)	Tax court jurisdiction to consider statute of limitations with respect to partners	Partnership tax years ending after date of enactment
6226(f)	1238(b)(1)	Determination of penalties at partnership level—conforming amendments	Partnership tax years ending after date of enactment
6227(b)-(d)	1236	Extension of time for filing a request for administrative adjustment	Partnership tax years beginning after September 3, 1982, generally
6227(e)	1243	Special rules for administrative adjustment requests with respect to bad debts or worthless securities	Partnership tax years beginning after September 3, 1982, generally
6229(b)(2), (3)	1233(c)	Provisions relating to statute of limitations—tax matters partner in bankruptcy	Agreements entered into after date of enactment
6229(d)(1)	1233(a)	Provisions relating to statute of limitations—suspension of statute where untimely petition filed	Partnership tax years with respect to which the period under Code Sec. 6229 for assessing tax has not expired on or before the date of enactment
6229(f)	1235	Exclusion of partial settlements from one year limitation on assessment	Settlements entered into after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
6229(h)	1233(b)	Provisions relating to statute of limitations—suspension of statute during bankruptcy proceeding	Partnership tax years with respect to which the period under Code Sec. 6229 for assessing tax has not expired on or before the date of enactment
6230(a)(1)	1237(c)(1)	Availability of innocent spouse relief in context of partnership proceedings—technical amendments	Partnership tax years beginning after September 3, 1982, generally
6230(a)(2)(A)	1238(b)(2)	Determination of penalties at partnership level—conforming amendment	Partnership tax years ending after date of enactment
6230(a)(3)	1237(a)	Availability of innocent spouse relief in context of partnership proceedings	Partnership tax years beginning after September 3, 1982, generally
6230(a)(3)(A), (B)	1238(b)(3)(A), (B)	Determination of penalties at partnership level—conforming amendments	Partnership tax years ending after date of enactment
6230(c)(1)(A)-(C)	1238(b)(4)	Determination of penalties at partnership level—conforming amendments	Partnership tax years ending after date of enactment
6230(c)(2)(A)	1238(b)(5)	Determination of penalties at partnership level—conforming amendment	Partnership tax years ending after date of enactment
6230(c)(4)	1238(b)(6)	Determination of penalties at partnership level—conforming amendment	Partnership tax years ending after date of enactment
6230(c)(5)	1237(b)	Availability of innocent spouse relief in context of partnership proceedings—claims for refund	Partnership tax years beginning after September 3, 1982, generally
6230(c)(5)(A), (D)	1238(b)(3)(C), (D)	Determination of penalties at partnership level—conforming amendments	Partnership tax years ending after date of enactment
6230(d)(6)	1239(c)(1)	Tax court jurisdiction to determine overpayments attributable to affected items	Partnership tax years ending after date of enactment
6231(a)(1)(B)	1234	Expansion of small partnership exception	Partnership tax years ending after date of enactment
6231(f)	1141(b)	Clarification of application of return requirement to foreign partnerships—sanction for failure to comply with section 6031 to include denial of deduction	Tax years beginning after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
6231(g)	1232	Partnership return to be determinative of audit procedures to be followed	Partnership tax years ending after date of enactment
6234	1231(a)	Treatment of partnership items in deficiency proceedings	Partnership tax years ending after date of enactment
6240	1222(a)	Simplified audit procedures for electing large partnerships	Partnership tax years ending on or after December 31, 1997
6241	1222(a)	Simplified audit procedures for electing large partnerships	Partnership tax years ending on or after December 31, 1997
6242	1222(a)	Simplified audit procedures for electing large partnerships	Partnership tax years ending on or after December 31, 1997
6245	1222(a)	Simplified audit procedures for electing large partnerships	Partnership tax years ending on or after December 31, 1997
6246	1222(a)	Simplified audit procedures for electing large partnerships	Partnership tax years ending on or after December 31, 1997
6247	1222(a)	Simplified audit procedures for electing large partnerships	Partnership tax years ending on or after December 31, 1997
6248	1222(a)	Simplified audit procedures for electing large partnerships	Partnership tax years ending on or after December 31, 1997
6251	1222(a)	Simplified audit procedures for electing large partnerships	Partnership tax years ending on or after December 31, 1997
6252	1222(a)	Simplified audit procedures for electing large partnerships	Partnership tax years ending on or after December 31, 1997
6255	1222(a)	Simplified audit procedures for electing large partnerships	Partnership tax years ending on or after December 31, 1997
6311	1205(a)	Payment of tax by commercially acceptable means	Nine months after date of enactment
6331(h), (i)	1024	Continuous levy on certain payments	Levies issued after date of enactment
6334(a)(13)	312(d)(1)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
6334(f), (g)	1025	Modification of levy exemption	Levies issued after date of enactment
6416(a)(4)(B)	905(a)	Operators of multiple gasoline retail outlets treated as wholesale distributor for refund purposes	Sales after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
6416(b)(2)(F)	1032(e)(6)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998
6416(d)	1436(b)	Allowance or credit of refund for tax-paid aviation fuel purchased by registered producer of aviation fuel—conforming amendment	Fuel acquired by the producer after September 30, 1997
6421(e)(2)(B)	902(a)	Repeal of tax on diesel fuel used in recreational boats	January 1, 1998
6422(5)-(13)	1131(c)(3)	Recognition of gain on certain transfers to foreign trusts and estates—technical and conforming amendment	Date of enactment
6427(f)(1)-(3)	1032(e)(7), (8)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998
6427(i)(3)(A)	1032(e)(9)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998
6427(i)(4)	1032(e)(10)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998
6427(l)(1), (2), (5)	1032(c)(3)	Kerosene taxed as diesel fuel—refunds	July 1, 1998
6501(a)	1284	Clarification of statute of limitations	Tax years beginning after date of enactment
6501(c)(8)	1145	Extension of statute of limitation for foreign transfers	Information that must be reported after date of enactment
6501(c)(9)	506(b)	Gifts may not be revalued for estate tax purposes after expiration of statute of limitations—modification of application of statute of limitations	Gifts made in calendar years ending after date of enactment
6501(o)(3)	1239(e)(2)	Provisions relating to court jurisdiction, etc.	Partnership tax years ending after date of enactment
6503(a)	1237(c)(2)	Availability of innocent spouse relief in context of partnership proceedings—technical amendments	Partnership tax years beginning after September 3, 1982, generally
6504(4)	312(d)(13)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
6511(d)(3)(A)	1056	Clarification of period of limitations on claim for credit or refund attributable to foreign tax credit	Taxes paid or accrued in tax years beginning after date of enactment
6511(d)(7)	1454(b)(1)	Proceedings for determination of employment status—conforming amendment	Date of enactment
6512(b)(2), (4)	1451	Overpayment determinations of Tax Court	Date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
6512(b)(3)	1239(c)(2)	Tax court jurisdiction to determine overpayments attributable to affected items	Partnership tax years ending after date of enactment
6512(b)(3)	1282	Clarification of period for filing claims for refunds	Claims for credit or refund for tax years ending after date of enactment
6601(c)	1242	Suspension of interest where delay in computational adjustment resulting from certain settlements	Adjustments with respect to partnership tax years beginning after date of enactment
6601(d)(2)-(4)	1055(a)	Interest on underpayments not reduced by foreign tax credit carrybacks	Foreign tax credit carrybacks arising in tax years beginning after date of enactment
6601(j)	503(c)(3)	Modifications to rate of interest on portion of estate tax extended under section 6166—conforming amendments	Estates of decedents dying after December 31, 1997
6601(j)(1), (2)	503(a)	Modifications to rate of interest on portion of estate tax extended under section 6166	Estates of decedents dying after December 31, 1997, generally
6601(j)(3), (4)	501(e)	Cost-of-living adjustments relating to estate and gift tax provisions—amount subject to reduced rate where extension of time for payment of estate tax on closely held business	Estates of decedents dying, and gifts made, after December 31, 1997
6601(j)(4)	503(c)(2)	Modifications to rate of interest on portion of estate tax extended under section 6166—conforming amendments	Estates of decedents dying after December 31, 1997
6611(f)(2)-(4)	1055(b)(1)	Interest on underpayments not reduced by foreign tax credit carrybacks—conforming amendment	Foreign tax credit carrybacks arising in tax years beginning after date of enactment
6611(f)(4)	1055(b)(2)(A)	Interest on underpayments not reduced by foreign tax credit carrybacks—conforming amendment	Foreign tax credit carrybacks arising in tax years beginning after date of enactment
6611(f)(4)(B)	1055(b)(2)(B), (C)	Interest on underpayments not reduced by foreign tax credit carrybacks—conforming amendment	Foreign tax credit carrybacks arising in tax years beginning after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
6611(g)-(i)	1055(b)(2)(D)	Interest on underpayments not reduced by foreign tax credit carrybacks—conforming amendment	Foreign tax credit carrybacks arising in tax years beginning after date of enactment
6621(a)(1)	1604(b)(1)	Miscellaneous provisions—amendments related to Uruguay Round Agreements Act	Determining interest for periods after December 31, 1994
6621(c)(2)(B)	1463	Certain notices disregarded under provision increasing interest rate on large corporate underpayments	Determining interest for periods after December 31, 1997
6652(e)	1602(d)(2)(B)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 323	Benefits paid after December 31, 1996
6652(g)	1281(a)	Reasonable cause exception for certain penalties—information on deductible employee contributions	Tax years beginning after date of enactment
6652(k)	1281(b)	Reasonable cause exception for certain penalties—reports on status as qualified small business	Tax years beginning after date of enactment
6654(d)(1)(C)	1091	Modification of estimated tax safe harbors	Any installment payment for tax years beginning after December 31, 1997
6654(e)(1)	1202	Increase in amount of tax exempt from estimated tax requirements	Tax years beginning after December 31, 1997
6655(g)(3)	1461	Extension of due date of first quarter estimated tax payment by private foundations	Determining underpayments of estimated tax for tax years beginning after date of enactment
6662(d)(2)(B)	1028(c)(1)	Registration and other provisions relating to confidential corporate tax shelters—modifications to substantial understatement penalty	Items with respect to transactions entered into after date of enactment
6662(d)(2)(C)	1028(c)(2)	Registration and other provisions relating to confidential corporate tax shelters—modifications to substantial understatement penalty	Items with respect to transactions entered into after date of enactment
6679(a)	1143(b)	Modifications relating to returns required to be filed by reason of changes in ownership interests in foreign partnership—penalty on failure to report changes in ownership interests	Transfers and changes after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
6683	1281(c)	Reasonable cause exception for certain penalties—returns of personal holding company tax by foreign corporations	Tax years beginning after date of enactment
6693	211(e)(2)(C)	Modifications of qualified state tuition programs—technical amendments	January 1, 1998, generally
6693(a)	1602(a)(4)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 301	Tax years beginning after December 31, 1996
6693(a)(2)	211(e)(2)(B)	Modifications of qualified state tuition programs—technical amendments	January 1, 1998, generally
6693(a)(2)(B)-(D)	213(c)	Failure to provide reports on education individual retirement accounts	Tax years beginning after December 31, 1997
6693(c)(2)	1601(d)(1)(C)	Technical amendments related to Small Business Job Protection Act of 1996—amendments related to subtitle D	Tax years beginning after December 31, 1996
6695(g)	1085(a)(2)	Restrictions on availability of earned income credit for taxpayers who improperly claimed credit in prior year—due diligence requirement on income tax return preparers	Tax years beginning after December 31, 1996
6707(a)(1)(A)	1028(d)(2)	Registration and other provisions relating to confidential corporate tax shelters—conforming amendment	Any tax shelter interests offered to potential participants after Secretary of the Treasury prescribes guidance implementing the Act
6707(a)(2)	1028(d)(1)	Registration and other provisions relating to confidential corporate tax shelters—conforming amendment	Any tax shelter interests offered to potential participants after Secretary of the Treasury prescribes guidance implementing the Act
6707(a)(3)	1028(b)	Registration and other provisions relating to confidential corporate tax shelters—penalty	Any tax shelter interests offered to potential participants after Secretary of the Treasury prescribes guidance implementing the Act

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
6715(c)(1)	1032(e)(11)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998
6724(d)(1)(A)	1213(b)	Qualified lessee construction allowances for short-term leases—treatment as information return	Leases entered into after date of enactment
6724(d)(1)(B)	201(c)(2)(A)	Hope and lifetime learning credits—returns relating to higher education tuition and related expenses	Expenses paid after December 31, 1997 (in tax years ending after such date), for education furnished in academic periods beginning after such date, generally
6724(d)(2)(Q)-(Y)	1602(d)(2)(A)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 323	Benefits paid after December 31, 1996
6724(d)(2)(Z)	201(c)(2)(B)	Hope and lifetime learning credits—returns relating to higher education	Expenses paid after December 31, 1997 (in tax years ending after such date), for education furnished in academic periods beginning after such date, generally
6724(e)	1223(b)	Due date for furnishing information to partners of electing large partnerships—treatment as information return	Partnership tax years ending on or after December 31, 1997
7232	1032(e)(12)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998
7421(a)	1222(b)(1)	Simplified audit procedures for electing large partnerships—conforming amendment	Partnership tax years ending on or after December 31, 1997
7421(a)	1239(e)(3)	Provisions relating to court jurisdiction, etc.	Partnership tax years ending after date of enactment
7421(a)	1454(b)(2)	Proceedings for determination of employment status—conforming amendment	Date of enactment
7430(b)(5)	1285(b)	Awarding of administrative costs—period for applying to IRS for costs	Civil actions or proceedings commenced after date of enactment
7430(c)(4)(D)	1453	Application of net worth requirement for awards of litigation costs	Proceedings commenced after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
7430(f)(2)	1285(c)	Awarding of administrative costs—period for petitioning of Tax Court for review of denial of costs	Civil actions or proceedings commenced after date of enactment
7430(f)(3)	1285(a)	Awarding of administrative costs—right to appeal Tax Court decision	Civil actions or proceedings commenced after date of enactment
7431(g)	1205(c)(2)	Payment of tax by commercially acceptable means—amendments to sections 6103 and 7431 with respect to disclosure authorization	Nine months after date of enactment
7436	1454(a)	Proceedings for determination of employment status	Date of enactment
7437	1454(a)	Proceedings for determination of employment status	Date of enactment
7453	1454(b)(3)	Proceedings for determination of employment status—conforming amendment	Date of enactment
7459(c)	1222(b)(2)	Simplified audit procedures for electing large partnerships—conforming amendment	Partnership tax years ending on or after December 31, 1997
7459(c)	1239(e)(1)	Provisions relating to court jurisdiction, etc.	Partnership tax years ending after date of enactment
7477	506(c)	Gifts may not be revalued for estate tax purposes after expiration of statute of limitations—declaratory judgment procedure for determining value of gift	Gifts made after date of enactment
7479	505(a)	Clarification of judicial review of eligibility for extension of time for payment of estate tax	Estates of decedents dying after date of enactment
7481(b)	1454(b)(3)	Proceedings for determination of employment status—conforming amendment	Date of enactment
7481(c)	1452	Redetermination of interest pursuant to motion	Date of enactment
7482(b)(1)	1239(d)(2)	Provisions relating to court jurisdiction, etc.—venue on appeal	Partnership tax years ending after date of enactment
7482(b)(1)(D)-(F)	1239(d)(1)	Provisions relating to court jurisdiction, etc.—venue on appeal	Partnership tax years ending after date of enactment
7482(b)(1)(E)	1222(b)(3)	Simplified audit procedures for electing large partnerships—conforming amendment	Partnership tax years ending on or after December 31, 1997
7485(b)	1222(b)(4)	Simplified audit procedures for electing large partnerships—conforming amendment	Partnership tax years ending on or after December 31, 1997

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
7485(b)	1241	Bonds in case of appeals from certain proceedings	Partnership tax years beginning after September 3, 1982, generally
7508A	911	Authority to postpone certain tax-related deadlines by reason of presidentially-declared disaster	Any period for performing an act that has not expired before date of enactment
7518(g)(6)(A)	311(c)(2)	Maximum capital gains rate for individuals—other conforming amendments	Tax years ending after May 6, 1997
7519(f)(4)(A)	1281(d)	Reasonable cause exception for certain penalties—failure to make required payments	Tax years beginning after date of enactment
7701(a)(4)	1151	Determination of foreign or domestic status of partnerships	Date of enactment, generally
7701(a)(30)(E)	1601(i)(3)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle I	Tax years beginning after December 31, 1996, generally
7701(b)(7)(A), (D)	1174(b)	Treatment of nonresident aliens engaged in international transportation services—presence in U.S.	Tax years beginning after December 31, 1997
7702B(c)(2)(B)	1602(b)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 322	Contracts issued after December 31, 1996, generally
7702B(g)(4)(B)	1602(e)	Amendments related to Health Insurance Portability and Accountability Act of 1996—amendments related to section 325	Contracts issued after December 31, 1996
7704(g)	964	Election for 1987 partnerships to continue exception from treatment of publicly traded partnerships as corporations	Tax years beginning after December 31, 1997
7872(f)(11)(A)	312(d)(1)	Exemption from tax for gain on sale of principal residence—conforming amendments	Sales and exchanges after May 6, 1997, generally
9502(b)(1)(C), (D)	1031(d)(1)	Extension and modification of airport and airway trust fund taxes—increased trust fund deposits	Taxes received in the Treasury on and after October 1, 1997
9502(f)	1031(d)(2)	Extension and modification of airport and airway trust fund taxes—increased trust fund deposits	Taxes received in the Treasury on and after October 1, 1997
9503(b)(1)(E)	1032(e)(13)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
9503(b)(4)	901(a)	General revenue portion of highway motor fuels taxes deposited into highway trust fund	Taxes received in the Treasury after September 30, 1997
9503(b)(5)(B)	1032(e)(14)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998
9503(c)(2)(A)	901(d)(2)	General revenue portion of highway motor fuels taxes deposited into highway trust fund—technical amendments	Taxes received in the Treasury after September 30, 1997
9503(c)(2)(A)	1601(f)(2)(A)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	Vehicles purchased after August 20, 1996
9503(c)(4)(D)	901(d)(3)	General revenue portion of highway motor fuels taxes deposited into highway trust fund—technical amendments	Taxes received in the Treasury after September 30, 1997
9503(c)(5)(B)	901(d)(3)	General revenue portion of highway motor fuels taxes deposited into highway trust fund—technical amendments	Taxes received in the Treasury after September 30, 1997
9503(c)(6)(D)	901(d)(3)	General revenue portion of highway motor fuels taxes deposited into highway trust fund—technical amendments	Taxes received in the Treasury after September 30, 1997
9503(c)(7)	901(c)	General revenue portion of highway motor fuels taxes deposited into highway trust fund—limitation on expenditures	Taxes received in the Treasury after September 30, 1997
9503(e)(2)	901(b)	General revenue portion of highway motor fuels taxes deposited into highway trust fund—mass transit portion	Taxes received in the Treasury after September 30, 1997
9503(e)(5)(A)	1601(f)(2)(B)	Technical amendments related to Small Business Job Protection Act of 1996—amendment related to subtitle F	Vehicles purchased after August 20, 1996
9503(f)	901(d)(1)	General revenue portion of highway motor fuels taxes deposited into highway trust fund—technical amendments	Taxes received in the Treasury after September 30, 1997
9508(b)(2)	1032(e)(13)	Kerosene taxed as diesel fuel—conforming amendment	July 1, 1998
9801(c)(1)	1531(b)(1)(A)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996—conforming amendment	Group health plans for plan years beginning on or after January 1, 1998

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
9802(c)	1532(a)	Special rules relating to church plans	Plan years beginning after June 30, 1997, generally
9804	1531(a)(2)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996	Group health plans for plan years beginning on or after January 1, 1998
9805	1531(a)(2)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996	Group health plans for plan years beginning on or after January 1, 1998
9806	1531(a)(2)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996	Group health plans for plan years beginning on or after January 1, 1998
9811	1531(a)(4)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996—standards relating to benefits for mothers and newborns	Group health plans for plan years beginning on or after January 1, 1998
9812	1531(a)(4)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996—parity in the application of certain limits to mental health benefits	Group health plans for plan years beginning on or after January 1, 1998
9831	1531(a)(2)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996	Group health plans for plan years beginning on or after January 1, 1998
9831(b)	1531(b)(1)(B)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996—conforming amendment	Group health plans for plan years beginning on or after January 1, 1998
9831(c)(1)-(3)	1531(b)(1)(C)-(E)	Amendments to the Internal Revenue Code of 1986 to implement	Group health plans for plan years beginning

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
		the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996—conforming amendment	on or after January 1, 1998
9832	1531(a)(2)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996	Group health plans for plan years beginning on or after January 1, 1998
9833	1531(a)(2)	Amendments to the Internal Revenue Code of 1986 to implement the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996	Group health plans for plan years beginning on or after January 1, 1998

EFFECTIVE DATES

Balanced Budget Act of 1997

¶ 17

This CCH-prepared table presents the general effective dates for the substantive and major law provisions added, amended or repealed by the Balanced Budget Act of 1997 (P.L. 105-33), enacted August 5, 1997. Entries are listed in Code Section order.

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
	4001	Medicare+Choice Program	Date of enactment
	9302(j)	Increase in excise taxes on tobacco products—floor stock taxes	Articles removed after December 31, 1999, generally
138	4006(a)	Medicare+Choice Medical Savings Account Program	Tax years beginning after December 31, 1998
139	4006(a)	Medicare+Choice Medical Savings Account Program	Tax years beginning after December 31, 1998
220(b)(7)	4006(b)(2)	Medicare+Choice Medical Savings Account Program—technical amendment	Tax years beginning after December 31, 1998
501(o), (p)	4041	Tax treatment of hospitals which participate in provider-sponsored organizations	Date of enactment
3306(c)(19)-(21)	5406	Treatment of certain services performed by inmates	Service performed after January 1, 1994
3309(b)(1)(A)	5407	Exemption of service performed for an elementary or secondary school operated primarily for religious purposes from federal unemployment tax	Service performed after date of enactment
3309(b)(3)(D)-(F)	5405	Exemption of service performed by election workers from federal unemployment tax	Service performed after date of enactment
4973(d)	4006(b)(1)	Medicare+Choice Medical Savings Account Program—technical amendment	Tax years beginning after December 31, 1998
5701(a)-(h)	9302(a)-(g)	Increase in excise taxes on tobacco products	Articles removed after December 31, 1999, generally
5701(c)	9302(h)(3)	Restriction on importation of previously exported tobacco products—books of 25 or fewer cigarette papers subject to tax	Articles removed after December 31, 1999, generally
5702(k)	9302(h)(4)	Restriction on importation of previously exported tobacco products—storage of tobacco products	Articles removed after December 31, 1999, generally

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
5704(b)	9302(h)(1)(A)	Increase in excise taxes on tobacco products—modifications of certain tobacco tax provisions	Articles removed after December 31, 1999, generally
5712	9302(h)(2)(A)	Restriction on importation of previously exported tobacco products—importers required to be qualified	Articles removed after December 31, 1999, generally
5712(1)-(3)	9302(h)(5)	Restriction on importation of previously exported tobacco products—authority to prescribe minimum manufacturing activity requirements	Articles removed after December 31, 1999, generally
5713(a)	9302(h)(2)(A)	Restriction on importation of previously exported tobacco products—importers required to be qualified	Articles removed after December 31, 1999, generally
5721	9302(h)(2)(A)	Restriction on importation of previously exported tobacco products—importers required to be qualified	Articles removed after December 31, 1999, generally
5722	9302(h)(2)(A)	Restriction on importation of previously exported tobacco products—importers required to be qualified	Articles removed after December 31, 1999, generally
5754	9302(h)(1)(E)	Restriction on importation of previously exported tobacco products	Articles removed after December 31, 1999, generally
5761(a)	9302(h)(1)(C)	Increase in excise taxes on tobacco products—modifications of certain tobacco tax provisions	Articles removed after December 31, 1999, generally
5761(c)-(e)	9302(h)(1)(B)	Increase in excise taxes on tobacco products—modifications of certain tobacco tax provisions	Articles removed after December 31, 1999, generally
5761(d)	9302(h)(1)(D)	Increase in excise taxes on tobacco products—modifications of certain tobacco tax provisions	Articles removed after December 31, 1999, generally
5762(a)(1)	9302(h)(2)(A)	Restriction on importation of previously exported tobacco products—importers required to be qualified	Articles removed after December 31, 1999, generally
5763(b)	9302(h)(2)(A), (B)	Restriction on importation of previously exported tobacco products—importers required to be qualified	Articles removed after December 31, 1999, generally
5763(c)	9302(h)(2)(A)	Restriction on importation of previously exported tobacco products—importers required to be qualified	Articles removed after December 31, 1999, generally
6103(a)(3)	11024(b)(2)	Federal information sharing for verification of benefit determinations	Date of enactment
6103(i)(7)(B)	11024(b)(3)	Federal information sharing for verification of benefit determinations	Date of enactment
6103(l)(12)(F)	4631(c)(2)	Permanent extension and revision of certain secondary payer provisions—IRS-SSA-HCFA data match	Date of enactment, generally

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
6103(l)(16)	11024(b)(1)	Federal information sharing for verification of benefit determinations	Date of enactment
6103(p)(3)(A)	11024(b)(4)	Federal information sharing for verification of benefit determinations	Date of enactment
6103(p)(4)	11024(b)(5)	Federal information sharing for verification of benefit determinations	
6103(p)(4)(F)	11024(b)(6), (7)	Federal information sharing for verification of benefit determinations	Date of enactment
7213(a)(2)	11024(b)(8)	Federal information sharing for verification of benefit determinations	Date of enactment

[illegible]

EFFECTIVE DATES

Taxpayer Browsing Protection Act of 1997

¶ 19

This CCH-prepared table presents the general effective dates for the substantive and major law provisions added, amended or repealed by the Taxpayer Browsing Protection Act of 1997 (P.L. 105-35), enacted August 5, 1997. Entries are listed in Code Section order.

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
7213(a)(2)	2(b)(1)	Penalty for unauthorized inspection of tax returns or tax return information—technical amendment	Violations occurring on and after date of enactment
7213A	2(a)	Penalty for unauthorized inspection of tax returns or tax return information	Violations occurring on and after date of enactment
7431	3(d)(4)	Civil damages for unauthorized inspection of returns and return information; notification of unlawful inspection or disclosure—conforming amendment	Inspections and disclosures occurring on and after date of enactment
7431(a)(1), (2)	3(a)	Civil damages for unauthorized inspection of returns and return information	Inspections and disclosures occurring on and after date of enactment
7431(b)	3(c)	Civil damages for unauthorized inspection of returns and return information—no damages for inspection requested by taxpayer	Inspections and disclosures occurring on and after date of enactment
7431(c)(1)(A)	3(d)(1)	Civil damages for unauthorized inspection of returns and return information; notification of unlawful inspection or disclosure—conforming amendment	Inspections and disclosures occurring on and after date of enactment
7431(c)(1)(B)	3(d)(1)	Civil damages for unauthorized inspection of returns and return information; notification of unlawful inspection or disclosure—conforming amendment	Inspections and disclosures occurring on and after date of enactment
7431(c)(1)(B)	3(d)(2)	Civil damages for unauthorized inspection of returns and return information; notification of unlawful inspection or disclosure—conforming amendment	Inspections and disclosures occurring on and after date of enactment
7431(d)	3(d)(1)	Civil damages for unauthorized inspection of returns and return information; notification of unlawful inspection or disclosure—conforming amendment	Inspections and disclosures occurring on and after date of enactment

Code Sec.	Act Sec.	Act Provision Subject	Effective Date
7431(e)-(g)	3(b)	Notification of unlawful inspection or disclosure of returns and return information	Inspections and disclosures occurring on and after date of enactment
7431(f)	3(d)(3)	Civil damages for unauthorized inspection of returns and return information; notification of unlawful inspection or disclosure—conforming amendment	Inspections and disclosures occurring on and after date of enactment
7431(g)(2)	3(d)(6)	Civil damages for unauthorized inspection of returns and return information; notification of unlawful inspection or disclosure—conforming amendment	Inspections and disclosures occurring on and after date of enactment

CODE SECTIONS ADDED, AMENDED OR REPEALED

The list below notes all the Code Sections or subsections of the Internal Revenue Code that were added, amended or repealed by the Taxpayer Relief Act of 1997 (P.L. 105-34), the Balanced Budget Act of 1997 (P.L. 105-33), and the Taxpayer Browsing Protection Act of 1997 (P.L. 105-35). The first column indicates the Code Section added, amended or repealed and the second column indicates the Act Section. The Code Sections are listed under the pertinent Acts.

Taxpayer Relief Act of 1997

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Code Sec.	Act Sec.
1(h)	311(a)
23(a)(2)	1601(h)(2)(A)
23(b)(2)(B)	1601(h)(2)(B)
24	101(a)
25(e)(7)	312(d)(1)
25A	201(a)
26(b)(2)(E)-(Q)	213(e)(1)
26(b)(2)(N)-(P)	1602(a)(1)
30A	1601(f)(1)(A)
32(c)(2)(B)(iii)-(v)	1085(c)
32(c)(4)	312(d)(2)
32(c)(5)(B)	1085(d)(4)
32(c)(5)(B)(iii)-(vi)	1085(d)(1)-(3)
32(c)(5)(B)(iv)	1085(b)
32(k)-(m)	1085(a)(1)
32(m)	101(b)
39(a)(1)	1083(a)(1)
39(a)(2)	1083(a)(2)
39(d)(8)	701(b)(1)
41(c)(4)(B)	601(b)(1)
41(h)(1)	601(a)(1)-(2)
45C(b)(1)	601(b)(2)
45C(e)	604(a)
51(a)	603(d)(1)
51(c)(4)(B)	603(a)
51(d)(1)(F)-(H)	603(c)(1)
51(d)(2)(A)	603(b)(1)
51(d)(3)(A)	603(b)(2)
51(d)(9)-(12)	603(c)(2)
51(i)(3)	603(d)(2)
51A	801(a)
52(c)	1601(b)
55(b)(1)(A)(ii)	311(b)(2)(A)
55(b)(3)	311(b)(1)
55(c)(1)	1601(f)(1)(C)
55(e)	401(a)
56(a)(1)(A)(i)	402(a)
56(a)(5)	402(b)
56(a)(6)-(8)	403(a)
56(e)(1)(A)	312(d)(1)
56(e)(3)(B)(i)	312(d)(1)
56(g)(4)(B)(i)	1212(a)
57(a)(7)	311(b)(2)(B)
59(a)(2)	1057(a)
59(a)(3)	1103(a)
59(j)	1201(b)(1)
62(a)(2)(C)	975(a)
62(a)(17)	202(b)
63(c)(4)	1201(a)(2)(A)-(B)
63(c)(5)	1201(a)(1)
72(d)(1)(B)(iii)	1075(b)(1)-(2)
72(d)(1)(B)(iv)	1075(a)
72(t)(2)(E)	203(a)
72(t)(2)(F)	303(a)
72(t)(7)	203(b)
72(t)(8)	303(b)
101(a)(2)	1084(b)(2)
101(h)	1528(a)
108(f)(2)(B)	225(a)(1)
108(f)(2)(D)	225(a)(1)
108(f)(3)	225(a)(2)
110	1213(a)
121	312(a)
127(d)	221(a)
130(c)(1)-(2)	962(a)(1)-(3)
132(e)(2)	970(a)
132(f)(4)	1072(a)
135(c)(2)(C)	211(c)
135(c)(2)(C)	213(e)(2)
135(d)(2)-(4)	201(d)
137(b)(1)	1601(h)(2)(C)
143(i)(1)(C)(i)(I)	312(d)(1)
143(k)(11)	914
143(m)(6)(A)	312(d)(3)
145(b)(5)	222
148(c)(2)(B)-(E)	1444(a)
148(d)(3)	1443
148(f)(4)(B)(ii)(I)	1441
148(f)(4)(C)(xvii)	1442
148(f)(4)(D)(vii)	223(a)
148(f)(4)(E)	1444(b)
162(a)	1204(a)
162(l)(1)(B)	934(a)
162(l)(2)(B)	1602(c)
162(o)-(p)	1203(a)
163(h)(2)(E)	503(b)(2)(B)
163(h)(4)(A)(i)(I)	312(d)(1)
163(j)(2)(B)(iii)	1604(g)(1)
163(k)-(l)	503(b)(2)(A)
163(l)-(m)	1005(a)

Code Sec.	*Act Sec.*
165(i)(4)	912(a)
167(g)(6)	1086(a)
168(e)(3)(A)(i)-(iii)	1086(b)(1)
168(g)(3)(B)	1086(b)(2)
168(i)(8)(C)	1213(c)
168(i)(14)	1086(b)(3)
168(j)(6)	1604(c)(1)
170(e)(5)(D)(ii)	602(a)
170(e)(6)	224(a)
170(h)(5)(B)(ii)	508(d)
170(i)	973(a)
172(b)(1)(A)(i)-(ii)	1082(a)(1)-(2)
172(b)(1)(F)	1082(b)
198	941(a)
216(e)	312(d)(4)
219(c)(1)(B)(ii)	302(c)
219(g)(1)	301(b)(1)
219(g)(2)(A)(ii)	301(a)(2)
219(g)(3)(B)	301(a)(1)
219(g)(7)	301(b)(2)
220(c)(3)(A)-(D)	1602(a)(2)
220(d)(2)(C)	1602(a)(3)
221-222	202(a)
246(c)(1)(A)	1015(a)
246(c)(2)	1015(b)(1)
246(c)(3)(A)-(C)	1015(b)(2)
263(a)(1)(F)-(H)	1604(a)(1)
264(a)(1)	1084(a)(1)
264(a)(4)	1084(b)(1)
264(a)(4)	1602(f)(1)
264(b)-(e)	1084(a)(2)
264(d)(2)(B)(ii)	1602(f)(2)
264(d)(4)(B)	1602(f)(3)
264(f)	1084(c)
265(b)(4)(A)	1084(c)[(e)]
267(b)(11)-(13)	1308(a)
267(f)(4)	1604(e)(1)
274(n)(3)	969(a)
280A(c)(1)	932(a)
280A(d)(4)(A)	312(d)(1)
280F(a)(1)(C)	971(a)
304(a)(1)	1013(a)
304(b)(5)	1013(c)
312(k)(3)(B)	1604(a)(2)(A)-(B)
318(b)(8)	1142(e)(3)
351(c)	1012(c)(1)
351(e)(1)	1002(a)
351(g)-(h)	1014(a)
354(a)(2)(C)	1014(b)
354(a)(2)(B)	1014(e)(1)
354(a)(3)(A)	1014(e)(2)
355(a)(3)(D)	1014(c)
355(a)(3)(C)	1014(e)(1)
355(a)(4)(A)	1014(e)(2)
355(e)	1012(a)
355(f)	1012(b)(1)
356(e)-(g)	1014(d)
358(g)	1012(b)(2)
367(d)(2)(C)	1131(b)(4)
367(d)(3)	1131(b)[(c)](5)(A)
367(f)	1131(b)[(c)](2)

Code Sec.	*Act Sec.*
368(a)(2)(H)	1012(c)(2)
401(a)(1)	1530(c)(1)
401(a)(5)(G)	1505(a)(1)
401(a)(13)(C)-(D)	1502(b)
401(a)(26)(H)	1505(a)(2)
401(k)(3)(G)	1505(b)
401(k)(7)(B)(iii)-(v)	1525(a)(1)-(2)
401(k)(11)(B)(iii)	1601(d)(2)(D)
401(k)(11)(D)(ii)	1601(d)(2)(A)
401(k)(11)(E)	1601(d)(2)(B)
401(m)(11)	1601(d)(3)
402(g)(9)	1501(a)
403(b)(1)(A)(i)-(iii)	1601(d)(6)(B)
403(b)(3)	1504(a)(1)
403(b)(12)(C)	1505(c)
404(a)(3)(A)(i)-(ii)	1601(d)(2)(C)(i)-(ii)
404(a)(9)(C)	1530(c)(2)
408(i)	302(d)(1)-(2)
408(i)	1601(d)(1)(A)
408(k)(6)(H)	1601(d)(1)(B)
408(l)(2)(B)	1601(d)(1)(C)(i)(I)-(II)
408(m)(3)	304(a)
408(p)(2)(D)(i)	1601(d)(1)(E)
408(p)(2)(D)(iii)	1601(d)(1)(F)
408(p)(5)	1601(d)(1)(G)
408(p)(8)	1501(b)
408(p)(8)[(9)]	1601(d)(1)(D)
408A	302(a)
409(h)(2)	1506(a)(2)(A)-(B)
409(h)(2)(B)	1506(a)(1)
410(c)(2)	1505(a)(3)
411(a)(7)(B)	1071(a)(2)(A)
411(a)(11)(A)	1071(a)(1)
412(b)(2)(C)-(E)	1521(c)(1)
412(c)(7)	1521(a)(A)[1]-(B)[2]
412(c)(7)(D)(i)-(iii)	1521(c)(3)(A)
412(m)(5)(E)(ii)(II)	1604(b)(2)(A)
414(e)(5)	1522(a)(1)-(2)
414(e)(5)(A)	1601(d)(6)(A)
414(n)(3)(C)	1601(h)(2)(D)(i)
414(q)(7)	1601(d)(7)
414(t)(2)	1601(h)(2)(D)(ii)
415(b)(2)(G)	1527(a)
415(c)(6)	1530(c)(3)
415(e)(6)-(7)	1530(c)(4)(A)-(B)
415(k)(3)	1526(b)
415(n)	1526(a)
417(e)(1)-(2)	1071(a)(2)(A)
417(e)(1)-(2)	1071(a)(2)(B)
447(i)(3)-(6)	1081(a)
451(a)	913(a)(1)-(2)
457(e)(9)	1071(a)(2)(A)
457(e)(9)(A)	1071(a)(2)(B)
460(b)(2)(C)	1211(b)(1)
460(b)(6)	1211(a)
460(b)(7)	1211(b)(2)
464(f)(3)(B)(i)	312(d)(1)
471(b)-(c)	961(a)
475(e)-(g)	1001(b)
501(c)(26)	101(c)

Code Sec.	Act Sec.
501(c)(27)(B)	963(a)
501(c)(27)	963(b)
501(e)(1)(A)	974(a)
512(a)(3)(D)	312(d)(5)
512(b)(13)	1041(a)
512(e)(1)	1601(c)(4)(D)
512(e)(2)	1601(c)(4)(A)
512(e)(3)	1523(a)
513(i)	965(a)
528(b)	966(d)
528(c)(1)(A)-(C)	966(a)(1)(A)-(C)
528(c)(4)-(5)	966(a)(2)
528(c)(5)	966(c)
528(d)(3)(A)-(C)	966(b)
529(b)(5)	211(b)(4)
529(c)(2)	211(b)(3)(A)(i)
529(c)(3)(A)	211(d)
529(c)(4)	211(b)(3)(B)
529(c)(5)	211(b)(3)(A)(ii)
529(d)	211(e)(2)(A)
529(e)(1)(B)	1601(h)(1)(A)
529(e)(1)(C)	1601(h)(1)(B)
529(e)(2)	211(b)(1)
529(e)(3)	211(a)
529(e)(5)	211(b)(2)
530	213(a)
532(b)(4)	1122(d)(1)
542(c)(10)	1122(d)(1)
551(f)[(2)]	1122(d)(2)
593(e)(1)(A)	1601(f)(5)(A)
613A(c)(6)(H)	972(a)
641(b)	1601(i)(3)(B)
644	507(b)(1)
646	1305(a)
663(b)	1306(a)
663(b)(2)	1306(b)
663(c)	1307(a)(1)-(2)
663(c)	1307(b)
664(d)(1)(A)	1089(a)(1)
664(d)(1)(B)	1530(c)(5)
664(d)(1)(B)-(D)	1089(b)(1)
664(d)(1)(C)	1530(a)
664(d)(2)(A)	1089(a)(1)
664(d)(2)(B)	1530(c)(5)
664(d)(2)(B)-(D)	1089(b)(2)
664(d)(2)(C)	1530(a)
664(d)(4)	1089(b)(4)
664(g)	1530(b)
665(b)	507(a)(2)
665(c)	507(a)(1)
665(d)(1)	1604(g)(2)
674(b)(4)	1530(c)(6)
679(a)(3)(C)(ii)-(iii)	1601(i)(2)
684	1131(b)
685	1309(a)
691(c)(1)(C)	1073(b)(1)
704(c)(1)(B)	1063(a)
706(b)(5)	507(b)(2)
706(c)(2)	1246(b)
706(c)(2)(A)	1246(a)
721(c)	1131(b)[(c)](3)
721(d)	1131(b)[(c)](5)(B)
724(d)(2)	1062(b)(3)
731(a)(2)(B)	1062(b)(3)
731(c)(6)	1062(b)(3)
732(c)	1061(a)
732(c)(1)(A)	1062(b)(3)
735(a)(2)	1062(b)(3)
735(c)(1)	1062(b)(3)
737(b)(1)	1063(a)
751(a)(2)	1062(a)
751(b)(1)(A)-(B)	1062(b)(1)(A)
751(b)(3)	1062(b)(1)(B)
751(d)	1062(b)(2)
771-777	1221(a)
805(a)(4)(C)(ii)	1084(b)[(d)](1)(A)
805(a)(4)(D)(iii)	1084(b)[(d)](1)(B)
805(a)(4)(F)	1084(b)[(d)](1)(C)
807(aa)(2)(B)	1084(b)[(d)](2)(A)
807(b)(1)(B)	1084(b)[(d)](2)(B)
812(d)(1)(B)-(D)	1084(b)[(d)](3)
814(h)	1131(c)[(d)](1)
817(h)(2)(A)-(B)	1271(b)(8)(A)-(B)
832(b)(5)(B)(i)-(ii)	1084(b)[(d)](4)
833(b)(1)(A)	1604(d)(2)(A)(i)-(ii)
851(b)(2)-(4)	1271(a)
851(b)(3)	1271(b)(1)(A)-(B)
851(c)	1271(b)(2)
851(d)	1271(b)(3)
851(e)(1)	1271(b)(4)
851(e)(4)	1271(b)(5)
851(g)(3)	1271(b)(7)
851(g)-(h)	1271(b)(6)
852(b)(3)(D)(iii)	1254(b)(2)
852(b)(10)	1122(c)(2)
852(c)[(2)]	1122(c)(3)
853(c)	1053(b)
856(a)(6)	1251(b)(2)
856(c)(3)-(8)	1255(a)(1)-(3)
856(c)(5)(G)	1255(b)(1)
856(c)(5)(G)	1258
856(d)(2)(C)	1252(a)
856(d)(5)	1253
856(d)(7)	1252(b)
856(e)(2)	1257(a)(1)
856(e)(3)	1257(a)(2)(A)-(B)
856(e)(4)	1257(c)
856(e)(5)	1257(b)
856(i)(2)	1262
856(j)(4)-(5)	1261(a)
856(j)(5)(A)(ii)	1261(b)
856(k)	1251(b)(1)
857(a)(2)-(3)	1251(a)(1)
857(b)(3)(D)-(E)	1254(a)
857(b)(5)	1255(b)(2)
857(b)(6)(C)	1255(b)(3)
857(b)(6)(C)(iii)	1260
857(b)(7)(A)(i)	1254(b)(1)
857(d)(3)	1256
857(e)(2)(B)-(D)	1259
857(f)-(g)	1251(a)(2)
860L(b)(1)(A)	1601(f)(6)(A)

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860L(d)(2)	1601(f)(6)(B)	1034	312(b)
860L(e)(2)(A)	1601(f)(6)(E)(ii)	1035(c)-(d)	1131(b)[(c)](1)
860L(e)(2)(B)	1601(f)(6)(C)	1036(b)-(c)	1014(e)(3)
860L(e)(3)(A)	1601(f)(6)(D)	1038(e)	312(d)(8)
860L(e)(3)(D)	1601(f)(6)(E)(i)	1042(g)	968(a)
861(a)(3)	1174(a)(1)	1045	313(a)
863(c)(2)(B)	1174(a)(2)	1057	1131(c)[(d)](2)
864(b)(2)(A)(ii)	1162(a)	1059(a)(2)	1011(a)
877(d)(2)(B)	1602(g)(1)	1059(d)(1)	1011(c)
877(d)(2)(D)	1602(g)(2)	1059(d)(3)	1604(d)(1)
877(d)(3)	1602(g)(3)	1059(e)(1)	1011(b)
877(d)(4)(A)	1602(g)(4)(A)-(C)	1059(e)(1)(A)(iii)	1013(b)
877(e)(1)	1602(h)(3)	1092(f)(2)	1271(b)(9)
894(c)	1054(a)	1201(a)(2)	314(a)
901(k)(4)	1142(e)(4)	1223(7)	312(d)(9)
901(k)-(l)	1053(a)	1223(15)-(16)	313(b)(2)
902(b)	1113(a)(1)	1233(h)	1003(b)(1)
902(c)(2)(B)	1163(a)	1234A(1)	1003(a)(1)
902(c)(3)	1113(a)(2)(C)	1239(b)(2)-(3)	1308(b)
902(c)(3)	1113(a)(2)(D)	1245(a)(2)(C)	1604(a)(3)
902(c)(3)(B)(i)-(iii)	1113(a)(2)(A)	1245(a)(3)(C)	1604(a)(3)
902(c)(4)(B)	1113(a)(2)(B)	1250(d)(7)-(10)	312(d)(10)(A)
904(b)(2)(C)	311(c)(3)	1250(e)(3)	312(d)(10)(B)
904(d)(1)(E)	1105(a)(1)	1259	1001(a)
904(d)(2)(C)(i)(II)	1163(b)	1271(b)	1003(c)(1)
904(d)(2)(C)(iii)(II)	1105(a)(3)	1272(a)(6)(C)(i)-(iii)	1004(a)
904(d)(2)(D)	1105(a)(3)	1274(c)(3)(B)	312(d)(1)
904(d)(2)(E)(i)	1111(b)	1291(a)(3)(A)	1122(b)(3)
904(d)(2)(E)(iv)	1105(a)(2)	1291(d)	1122(b)(2)
904(d)(4)-(6)	1105(b)	1291(d)(1)	1122(b)(1)
904(j)-(k)	1101(a)	1293(a)(1)	1122(d)(3)
905(c)	1102(a)(2)	1293(d)	1122(d)(3)
911(b)(2)(A)	1172(a)(1)	1296(e)	1121
911(b)(2)(D)	1172(a)(2)	1296-1298	1122(a)
927(a)(2)(B)	1171(a)	1297(a)	1123(b)(1)-(2)
951(a)(2)	1112(a)(1)	1297(b)(3)	1122(d)(4)
952(b)	1112(c)(1)	1297(e)	1123(a)
954(c)(1)(B)	1051(a)(2)(A)-(B)	1298(b)(1)	1122(e)
954(c)(1)(F)-(G)	1051(a)(1)	1301	933(a)
954(c)(2)(C)	1051(b)	1361(b)(1)(B)	1601(c)(4)(C)
954(e)(2)(A)-(C)	1175(b)	1361(b)(3)(A)	1601(c)(3)
954(h)	1175(a)	1361(c)(6)-(7)	1601(c)(4)(B)
956(b)(1)(A)	1601(e)	1361(e)(1)(B)(i)-(iii)	1601(c)(1)
956(c)(2)(H)-(K)	1173(a)	1374(d)(7)	1601(f)(5)(B)
960(a)(1)	1113(b)	1391(b)(2)	951(a)(1)-(3)
961(c)	1112(b)(1)	1391(c)	952(d)(2)
964(e)	1111(a)	1391(e)	952(d)(1)
986(a)	1102(a)(1)	1391(f)	952(d)(1)
986(a)(3)-(4)	1102(b)(1)	1391(g)	952(a)
988(e)	1104(a)	1392(d)	954
989(b)	1102(b)(3)	1394(b)(2)	955(b)
989(c)(4)-(6)	1102(b)(2)	1394(b)(3)	955(a)
1014(a)(1)-(4)	508(b)	1394(f)	953(a)
1016(a)(7)	312(d)(6)	1396(b)	951(b)(1)-(2)
1016(a)(23)	313(b)(1)(A)-(B)	1396(e)	952(b)
1016(a)(25)-(27)	701(b)(2)	1397A(c)	952(c)
1031(h)	1052(a)	1397B(b)-(c)	956(a)(1)-(3)
1033(e)	913(b)(1)-(2)	1397B(d)(2)-(3)	956(a)(4)-(5)
1033(h)(4)	312(d)(1)	1397B(f)	956(a)(6)
1033(i)	1087(a)	1397E-1397F	226(a)
1033(k)(3)	312(d)(7)	1400-1400C	701(a)

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1402(k)	922(a)	4041(l)	1601(f)(4)(A)(i)-(ii)
1441(g)	1604(g)(3)	4041(m)(1)(A)	907(b)
1445(e)(1)	311(c)(1)	4051(b)(2)(B)	1401(a)
1491-1494	1131(a)	4051(d)-(e)	1432(a)
2001(c)(2)	501(a)(1)(D)	4051(e)	1402(a)
2001(f)	506(a)	4052(b)(1)(B)(ii)-(iv)	1402(b)
2010(a)	501(a)(1)(A)	4052(d)	1434(b)(1)
2010(c)-(d)	501(a)(1)(B)	4052(e)-(f)	1434(a)
2013(g)	1073(b)(2)	4052(g)	1434(b)(2)
2031(c)-(d)	508(a)	4081(a)(2)(A)(iii)	1032(b)
2032A(a)(3)	501(b)	4081(d)(2)(B)	1031(a)(2)
2032A(b)(5)(A)	504(b)	4081(d)(3)	1033
2032A(c)(7)(E)	504(a)	4082	1032(e)(3)(A)
2032A(c)(8)	508(c)	4082(a)	1032(c)(1)
2032A(d)(3)	1313(a)	4082(c)	1032(c)(1)
2033A	502(a)	4082(d)	1032(c)(1)
2035	1310(a)	4082(d)-(f)	1032(c)(2)
2053(c)(1)(B)	1073(b)(3)	4083(a)(3)	902(b)(3)
2053(c)(1)(D)	503(b)(1)	4083(a)[(1)](A)-(C)	1032(a)
2055(a)(3)-(5)	1530(c)(7)(i)[A]-(iii)[C]	4083(b)	1032(e)(4)
		4091(b)(3)(A)(ii)	1031(a)(1)
2055(e)(3)(G)	1089(b)(5)	4091(d)	1436(a)
2055(e)(3)(J)	1089(b)(3)	4092(b)	1601(f)(4)(C)
2056(b)(7)(C)	1311(a)	4093(a)	1032(e)(5)
2056(b)(8)	1530(c)(8)	4101(e)	1032(d)
2056A(a)(1)(A)	1314(a)	4131(b)	904(a)
2056A(c)(3)	1312(a)	4132(a)(1)	904(b)
2102(c)(3)(A)	501(a)(1)(E)	4132(a)(2)-(8)	904(c)
2105(b)(2)-(4)	1304(a)	4161(b)	1433(a)
2107(c)(2)(B)(i)	1602(g)(6)(A)	4222(b)(2)	1431(a)(1)-(2)
2107(c)(2)(C)	1602(g)(6)(B)	4251(d)	1034(a)
2207A(a)(2)	1302(a)	4261(a)-(c)	1031(c)(1)
2207B(a)(2)	1302(b)	4261(e)-(h)	1031(c)(2)
2501(a)(3)(C)	1602(g)(5)	4261(g)	1601(f)(4)(D)
2503(b)	501(c)(1)-(3)	4261(g)(1)(A)(ii)	1031(b)(1)
2504(c)	506(d)	4261(h)-(i)	1435(a)
2505(a)(1)	501(a)(2)	4263(c)	1031(c)(3)
2523(g)(1)	1604(g)(4)	4271(d)(1)(A)(ii)	1031(b)(2)
2612(c)(2)	511(b)(2)	4495-4498	1432(b)(1)
2612(c)(2)-(3)	511(b)(1)	4681(b)(1)(B)-(C)	1432(c)(1)
2652(b)(1)	1305(b)	4682(d)(1)	903(a)
2631(c)	501(d)	4682(g)	1432(c)(2)
2651(e)-(f)	511(a)	4947(b)(4)	1530(c)(9)
3301(1)-(2)	1035(1)-(2)	4962(b)	1603(a)
4001(a)	906(a)	4972(c)(6)(B)	1507(a)
4001(e)[(1)]	906(b)(1)	4973(a)(2)-(4)	213(d)(1)
4001(f)	906(b)(2)	4973(e)	213(d)(2)
4001(f)	1601(f)(3)(A)(i)-(ii)	4973(f)	302(b)
4001(g)	1601(f)(3)(B)	4975(a)	1074(a)
4003(a)(1)(A)	906(b)(3)	4975(c)(5)	213(b)(2)
4003(a)(2)(B)	906(b)(4)	4975(d)	1506(b)(1)(B)(i)-(ii)
4003(a)(3)(C)	1401(a)	4975(c)(4)	1602(a)(5)
4041(a)(1)(A)	902(b)(1)(A)-(B)	4975(e)(1)(D)-(F)	213(b)(1)
4041(a)(1)(D)	902(b)(2)	4975(e)(7)	1530(c)(10)
4041(a)(2)	907(a)(1)	4975(f)(6)	1506(b)(1)(A)
4041(a)(2)[(A)]	1032(e)(1)	4978(a)	1530(c)(11)(A)-(B)
4041(a)(2)	1601(f)(4)(B)	4978(b)(2)	1530(c)(12)(A)-(B)
4041(c)(1)	1032(e)(2)	4978(c)	1530(c)(13)
4041(c)(2)	1435(b)	4978(e)(2)	1530(c)(14)
4041(c)(3)(B)	1031(a)(3)	4979A(a)	1530(c)(15)
4041(d)(1)	907(a)(2)	4979A(c)	1530(c)(16)

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4979A(d)-(e)	1530(c)(17)	6045(e)(5)	312(c)
4980A	1073(a)	6045(f)	1021(a)
4980D(a)	1531(b)(2)(A)	6046(a)	1146(a)
4980D(c)(3)(B)(i)(I)	1531(b)(2)(B)	6046A(a)	1143(a)(1)
4980D(d)(1)	1531(b)(2)(C)	6046A(d)-(e)	1143(a)(2)
4980D(d)(3)	1531(b)(2)(D)	6048(b)	1601(i)(1)
4980D(f)(1)	1531(b)(2)(E)	6048(d)(5)	1027(b)
4982(e)(6)	1122(c)(1)	6050Q(b)(1)	1602(d)(1)
5008(c)(1)	1411(a)	6050R(c)(1)	1601(a)(1)
5041(b)(4)-(6)	908(a)	6050S	201(c)(1)
5041(c)(1)	908(b)	6050S(a)(2)	202(c)(1)
5044	1416(b)(2)	6050S(b)(2)(A)	202(c)(2)(A)
5044(a)	1416(a)	6050S(b)(2)(C)(i)-(iii)	202(c)(2)(B)
5053(f)	1414(b)	6050S(e)	202(c)(3)
5053(g)	1418(a)	6103(d)(5)	976(c)
5053(h)	1419(a)	6103(e)(1)(A)(iv)	1201(b)(2)
5053(i)	1414(b)	6103(h)(5)-(6)	1283(a)
5055	1420(a)	6103(k)(8)	1026(a)
5056(c)-(d)	1414(c)(1)-(2)	6103(k)(8)[(9)]	1205(c)(1)
5115	1415(a)	6103(l)(7)(D)(viii)	1023(a)
5175(c)	1412(a)	6103(p)(3)(A)	1026(b)(1)(A)
5207(c)	1413(a)	6103(p)(3)(A)	1205(c)(3)
5222(b)(2)	1414(a)	6103(p)(4)	1026(b)(1)(B)
5361	1416(b)(1)	6103(p)(4)	1283(b)
5364	1422(a)	6111(d)-(f)	1028(a)
5384(b)(2)(D)	1417(a)	6166(b)(7)(A)(iii)	503(c)(1)
5388(c)	910(a)	6166(b)(8)(A)(iii)	503(c)(1)
5418	1421(a)	6211(c)	1231(b)
5681(a)	1415(b)(1)	6212(c)(2)(C)-(E)	312(d)(12)
5681(c)	1415(b)(2)(A)-(B)	6213(g)(2)(G)-(I)	101(d)(2)
6011(e)(2)	1224	6213(g)(2)(H)-(J)	201(b)
6012(b)(6)	1225	6213(g)(2)(H)-(J)	1085(a)(3)
6012(c)	312(d)(11)	6221	1238(a)
6018(a)(4)	1073(b)(4)	6225(b)	1239(a)
6018(a)(1)	501(a)(1)(C)	6226(b)(5)-(6)	1240(a)
6019(1)-(3)	1301(a)	6226(d)(1)	1239(b)
6031(b)	1223(a)	6226(f)	1238(b)(1)(A)-(B)
6031(e)	1141(a)	6227(b)-(d)	1236(a)
6033(b)(10)	1603(b)(1)(A)	6227(e)	1243(a)
6033(b)(10)(C)	1603(b)(1)(B)	6229(b)(2)-(3)	1233(c)
6033(b)(11)	1603(b)(2)	6229(d)(1)	1233(a)
6034A(c)	1027(a)	6229(f)	1235(a)(1)-(3)
6038(a)	1142(a)	6229(h)	1233(b)
6038(a)(2)-(3)	1142(e)(1)(A)	6230(a)(1)	1237(c)(1)
6038(a)(5)	1142(d)	6230(a)(2)(A)(i)	1238(b)(2)
6038(b)	1142(c)(1)(A)-(B)	6230(a)(3)	1237(a)
6038(b)	1142(e)(1)(B)	6230(a)(3)(A)	1238(b)(3)(A)
6038(b)(2)	1142(c)(1)(B)	6230(a)(3)(B)	1238(b)(3)(B)
6038(c)	1142(e)(1)(C)	6230(c)(1)(A)-(C)	1238(b)(4)
6038(c)(1)(B)	1142(e)(2)	6230(c)(2)(A)	1238(b)(5)
6038(d)	1142(e)(1)(D)	6230(c)(4)	1238(b)(6)
6038(e)(1)-(4)	1142(b)(1)(A)-(C)	6230(c)(5)	1237(b)
6038(e)(2)	1142(b)(2)	6230(c)(5)(A)	1238(b)(3)(C)
6038(e)(4)	1142(e)(1)(E)	6230(c)(5)(D)	1238(b)(3)(D)
6038B(a)(1)	1144(a)	6230(d)(6)	1239(c)(1)
6038B(b)[(c(](1)	1144(c)(1)	6231(a)(1)(B)(i)	1234(a)
6038B(b)[(c)](3)	1144(c)(2)	6231(f)	1141(b)(1)-(2)
6038B(b)-(c)	1144(b)	6231(g)	1232(a)
6039D(d)(1)	1601(h)(2)(D)(iii)	6234	1231(a)
6039G	1602(h)(1)	6240-6242	1222(a)
6041A(d)(3)	1022(a)	6245-6248	1222(a)

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6251-6252	1222(a)
6255	1222(a)
6311	1205(a)
6331(h)-(i)	1024(a)(1)-(2)
6334(a)(13)	312(d)(1)
6334(f)-(g)	1025(a)
6416(a)(4)(B)	905(a)
6416(b)(2)(F)	1032(e)(6)
6416(d)	1436(b)
6421(e)(2)(B)	902(a)
6422(5)-(13)	1131(c)[(d)](3)
6427(f)	1032(e)(7)
6427(f)(1)	1032(e)(7)
6427(f)(2)	1032(e)(8)
6427(f)(3)	1032(e)(7)
6427(i)(3)(A)	1032(e)(9)
6427(i)(4)	1032(e)(10)
6427(i)(5)(A)(i)	1032(c)(3)(E)
6427(l)	1032(c)(3)(A) & (D)
6427(l)(5)[(C)]	1032(c)(3)(C)
6427(l)(5)(B)-(C)	1032(c)(3)(B)
6501(a)	1284(a)
6501(c)(8)	1145(a)
6501(c)(9)	506(b)
6501(o)(3)	1239(e)(2)
6503(a)	1237(c)(2)
6504(4)-(12)	312(d)(13)
6511(d)(3)(A)	1056(a)
6511(d)(7)	1454(b)(1)
6512(b)(2)	1451(a)
6512(b)(3)	1239(c)(2)
6512(b)(3)	1282(a)
6512(b)(4)	1451(b)
6601(c)	1242(a)
6601(d)(2)-(4)	1055(a)
6601(j)	503(c)(3)
6601(j)(1)-(2)	503(a)
6601(j)(3)-(4)	501(e)
6601(j)(4)	503(c)(2)
6611(f)(2)-(4)	1055(b)(1)
6611(f)(4)	1055(b)(2)(A)(i)-(ii)
6611(f)(4)(B)(ii)(I)-(III)	1055(b)(2)(B)
6611(f)(4)(B)(ii)(III)	1055(b)(2)(C)
6611(g)-(i)	1055(b)(2)(D)
6621(a)(1)	1604(b)(1)
6621(c)(2)(B)(iii)	1463(a)
6652(e)	1602(d)(2)(B)
6652(g)	1281(a)
6652(k)	1281(b)
6654(d)(1)(C)(i)	1091(a)
6654(e)(1)	1202(a)
6655(g)(3)	1461(a)
6662(d)(2)(B)	1028(c)(1)
6662(d)(2)(C)(iii)	1028(c)(2)
6679(a)	1143(b)
6683	1281(c)
6693	211(e)(2)(C)
6693(a)	1602(a)(4)
6693(a)(2)(A)-(C)	211(e)(2)(B)
6693(a)(2)(B)-(D)	213(c)
6693(c)(2)	1601(d)(1)(C)(ii)(I)-(II)
6695(g)	1085(a)(2)
6707(a)(1)(A)	1028(d)(2)
6707(a)(2)	1028(d)(1)
6707(a)(3)	1028(b)
6715(c)(1)	1032(e)(11)
6724(d)(1)(A)(vii)-(ix)	1213(b)
6724(d)(1)(B)(ix)-(xv)	201(c)(2)(A)
6724(d)(2)(Q)-(Y)	1602(d)(2)(A)
6724(d)(2)(X)-(Z)	201(c)(2)(B)
6724(e)	1223(b)
7232	1032(e)(12)(A)-(B)
7421(a)	1222(b)(1)
7421(a)	1239(e)(3)
7421(a)	1454(b)(2)
7430(b)(5)	1285(b)
7430(c)(4)(D)	1453(a)
7430(f)(2)	1285(c)(1)-(2)
7430(f)(3)	1285(a)
7431(g)	1205(c)(2)
7436-7437	1454(a)
7453	1454(b)(3)
7459(c)	1222(b)(2)
7459(c)	1239(e)(1)
7477	506(c)(1)
7479	505(a)
7481(b)	1454(b)(3)
7481(c)	1452(a)
7482(b)(1)	1239(d)(2)
7482(b)(1)(D)-(F)	1239(d)(1)
7482(b)(1)	1239(d)(1)
7482(b)(1)(E)	1222(b)(3)
7485(b)	1222(b)(4)(A)
7485(b)	1222(b)(4)(B)
7485(b)	1241(a)(1)-(2)
7508A	911(a)
7518(g)(6)(A)	311(c)(2)
7519(f)(4)(A)	1281(d)
7701(a)(4)	1151(a)
7701(a)(30)(E)(ii)	1601(i)(3)(A)
7701(b)(7)(A)	1174(b)(2)
7701(b)(7)(D)	1174(b)(1)
7702B(c)(2)(B)	1602(b)
7702B(g)(4)(B)(ii)-(iii)	1602(e)
7704(g)	964(a)
7872(f)(11)(A)	312(d)(1)
9502(b)(1)	1031(d)(1)(A)-(C)
9502(d)(5)-(6)	1604(g)(5)
9502(f)	1031(d)(2)
9503(b)(1)(E)	1032(e)(13)
9503(b)(4)	901(a)
9503(b)(5)(B)	1032(e)(14)
9503(c)(2)(A)	901(d)(2)
9503(c)(2)(A)(ii)	1601(f)(2)(A)
9503(c)(4)(D)	901(d)(3)
9503(c)(5)(B)	901(d)(3)
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5701(c)	9302(c)	6103(i)(7)(B)(i)	11024(b)(3)
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1062(b)(3)	731(a)(2)(B)
1062(b)(3)	731(c)(6)
1062(b)(3)	732(c)(1)(A)
1062(b)(3)	735(a)(2)
1062(b)(3)	735(c)(1)
1063(a)	737(b)(1)
1063(a)	704(c)(1)(B)
1071(a)(1)	411(a)(11)(A)
1071(a)(2)(A)	411(a)(7)(B)
1071(a)(2)(A)	417(e)(1)-(2)
1071(a)(2)(A)	457(e)(9)
1071(a)(2)(B)	417(e)(2)
1071(a)(2)(B)	457(e)(9)(A)

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1072(a)	132(f)(4)
1073(a)	4980A
1073(b)(1)	691(c)(1)(C)
1073(b)(2)	2013(g)
1073(b)(3)	2053(c)(1)(B)
1073(b)(4)	6018(a)(4)
1074(a)	4975(a)
1075(a)	72(d)(1)(B)(iv)
1075(b)(1)-(2)	72(d)(1)(B)(iii)
1081(a)	447(i)(3)-(6)
1082(a)(1)-(2)	172(b)(1)(A)(i)-(ii)
1082(b)	172(b)(1)(F)
1083(a)(1)	39(a)(1)
1083(a)(2)	39(a)(2)
1084(a)(1)	264(a)(1)
1084(a)(2)	264(b)-(e)
1084(b)(1)	264(a)(4)
1084(b)(2)	101(a)(2)
1084(c)	264(f)
1084(b)[(d)](1)(A)	805(a)(4)(C)(ii)
1084(b)[(d)](1)(B)	805(a)(4)(D)(iii)
1084(b)[(d)](1)(C)	805(a)(4)(F)
1084(b)[(d)](2)(A)	807(a)(2)(B)
1084(b)[(d)](2)(B)	807(b)(1)(B)
1084(b)[(d)](3)	812(d)(1)(B)-(D)
1084(b)[(d)](4)	832(b)(5)(B)(i)-(ii)
1084(c)[(e)]	265(b)(4)(A)
1085(a)(1)	32(k)-(m)
1085(a)(2)	6695(g)
1085(a)(3)	6213(g)(2)(H)-(J)
1085(b)	32(c)(5)(B)(iv)
1085(c)	32(c)(2)(B)(iii)-(v)
1085(d)(1)-(3)	32(c)(5)(B)(iii)-(vi)
1085(d)(4)	32(c)(5)(B)
1086(a)	167(g)(6)
1086(b)(1)	168(e)(3)(A)(i)-(iii)
1086(b)(2)	168(g)(3)(B)
1086(b)(3)	168(i)(14)
1087(a)	1033(i)
1089(a)(1)	664(d)(1)(A)
1089(a)(1)	664(d)(2)(A)
1089(b)(1)	664(d)(1)(B)-(D)
	664(d)(2)(B)-(D)
1089(b)(2)	664(d)(2)(B)-(D)
1089(b)(3)	2055(e)(3)(J)
1089(b)(4)	664(d)(4)
1089(b)(5)	2055(e)(3)(G)
1091(a)	6654(d)(1)(C)(i)
1101(a)	904(j)-(k)
1102(a)(1)	986(a)
1102(a)(2)	905(c)
1102(b)(1)	986(a)(3)-(4)
1102(b)(2)	989(c)(4)-(6)
1102(b)(3)	989(b)
1103(a)	59(a)(3)
1104(a)	988(e)
1105(a)(1)	904(d)(1)(E)
1105(a)(2)	904(d)(2)(E)(iv)
1105(a)(3)	904(d)(2)(C)(iii)(II)
1105(a)(3)	904(d)(2)(D)
1105(b)	904(d)(4)-(6)
1111(a)	964(e)
1111(b)	904(d)(2)(E)(i)
1112(a)(1)	951(a)(2)
1112(b)(1)	961(c)
1112(c)(1)	952(b)
1113(a)(1)	902(b)
1113(a)(2)(A)	902(c)(3)(B)(i)-(iii)
1113(a)(2)(B)	902(c)(4)(B)
1113(a)(2)(C)	902(c)(3)
1113(a)(2)(D)	902(c)(3)
1113(b)	960(a)(1)
1121	1296(e)
1122(a)	1296
1122(a)	1297
1122(a)	1298
1122(b)(1)	1291(d)(1)
1122(b)(2)	1291(d)
1122(b)(3)	1291(a)(3)(A)
1122(c)(1)	4982(e)(6)
1122(c)(2)	852(b)(10)
1122(c)(3)	852(c)[(2)]
1122(d)(1)	532(b)(4)
1122(d)(1)	542(c)(10)
1122(d)(2)	551(f)[(2)]
1122(d)(3)	1293(a)(1)
1122(d)(3)	1293(d)
1122(d)(4)	1297(b)(3)
1122(e)	1298(b)(1)
1123(a)	1297(e)
1123(b)(1)-(2)	1297(a)
1131(a)	1491
1131(a)	1492
1131(a)	1494
1131(b)	684
1131(b)[(c)](1)	1035(c)-(d)
1131(b)(2)	367(f)
1131(b)[(c)](3)	721(c)
1131(b)[(c)](4)	367(d)(2)(C)
1131(b)[(c)](5)(A)	367(d)(3)
1131(b)[(c)](5)(B)	721(d)
1131(c)[(d)](1)	814(h)
1131(c)[(d)](2)	1057
1131(c)[(d)](3)	6422(5)-(13)
1141(a)	6031(e)
1141(b)(1)-(2)	6231(f)
1142(a)	6038(a)
1142(b)(1)(A)-(C)	6038(e)(1)-(4)
1142(b)(2)	6038(e)(2)
1142(c)(1)(A)-(B)	6038(b)
1142(d)	6038(a)(5)
1142(e)(1)(A)	6038(a)(2)-(3)
1142(e)(1)(B)	6038(b)
1142(e)(1)(C)	6038(c)
1142(e)(1)(D)	6038(d)
1142(e)(1)(E)	6038(e)(4)
1142(e)(2)	6038(c)(1)(B)
1142(e)(3)	318(b)(8)
1142(e)(4)	901(k)(4)
1143(a)(1)	6046A(a)
1143(a)(2)	6046A(d)-(e)
1143(b)	6679(a)

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1144(a)	6038B(a)(1)
1144(b)	6038B(b)-(c)
1144(c)(1)	6038B(b)[(c)](1)
1144(c)(2)	6038B(b)[(c)](3)
1145(a)	6501(c)(8)
1146(a)	6046(a)
1151(a)	7701(a)(4)
1162(a)	864(b)(2)(A)(ii)
1163(a)	902(c)(2)(B)
1163(b)	904(d)(2)(C)(i)(II)
1171(a)	927(a)(2)(B)
1172(a)(1)	911(b)(2)(A)
1172(a)(2)	911(b)(2)(D)
1173(a)	965(c)(2)(H)-(K)
1174(a)(1)	861(a)(3)
1174(a)(2)	863(c)(2)(B)
1174(b)(1)	7701(b)(7)(D)
1174(b)(2)	7701(b)(7)(A)
1175(a)	954(h)
1175(b)	954(e)(2)(A)-(C)
1201(a)(1)	63(c)(5)
1201(a)(2)(A)-(B)	63(c)(4)
1201(b)(1)	59(j)
1201(b)(2)	6103(e)(1)(A)(iv)
1202(a)	6654(e)(1)
1203(a)	162(o)-(p)
1204(a)	162(a)
1205(a)	6311
1205(c)(1)	6103(k)(8)[(9)]
1205(c)(2)	7431(g)
1205(c)(3)	6103(p)(3)(A)
1211(a)	460(b)(6)
1211(b)(1)	460(b)(2)(C)
1211(b)(2)	460(b)(7)
1212(a)	56(g)(4)(B)(i)
1213(a)	110
1213(b)	6724(d)(1)(A)(vii)-(ix)
1213(c)	168(i)(8)(C)
1221(a)	771
1221(a)	772
1221(a)	773
1221(a)	774
1221(a)	775
1221(a)	776
1221(a)	777
1222(a)	6240
1222(a)	624
1222(a)	6242
1222(a)	6245
1222(a)	6246
1222(a)	6247
1222(a)	6248
1222(a)	6251
1222(a)	6252
1222(a)	6255
1222(b)(1)	7421(a)
1222(b)(2)	7459(c)
1222(b)(3)	7482(b)(1)(E)
1222(b)(4)(A)	7485(b)
1222(b)(4)(B)	7485(b)
1223(a)	6031(b)
1223(b)	6724(e)
1224	6011(e)(2)
1225	6012(b)(6)
1231(a)	6234
1231(b)	6211(c)
1232(a)	6231(g)
1233(a)	6229(d)(1)
1233(b)	6229(h)
1233(c)	6229(b)(2)-(3)
1234(a)	6231(a)(1)(B)(i)
1235(a)(1)-(3)	6229(f)
1236(a)	6227(b)-(d)
1237(a)	6230(a)(3)
1237(b)	6230(c)(5)
1237(c)(1)	6230(a)(1)
1237(c)(2)	6503(a)
1238(a)	6221
1238(b)(1)(A)-(B)	6226(f)
1238(b)(2)	6230(a)(2)(A)(i)
1238(b)(3)(A	6230(a)(3)(A))
1238(b)(3)(B)	6230(a)(3)(B)
1238(b)(3)(C)	6230(c)(5)(A)
1238(b)(3)(D)	6230(c)(5)(D)
1238(b)(4)	6230(c)(1)(A)-(C)
1238(b)(5)	6230(c)(2)(A)
1238(b)(6)	6230(c)(4)
1239(a)	6225(b)
1239(b)	6226(d)(1)
1239(c)(1)	6230(d)(6)
1239(c)(2)	6512(b)(3)
1239(d)(1)	7482(b)(1)(D)-(F)
1239(d)(1)	7482(b)(1)
1239(d)(2)	7482(b)(1)
1239(e)(1)	7459(c)
1239(e)(2)	6501(o)(3)
1239(e)(3)	7421(a)
1240(a)	6226(b)(5)-(6)
1241(a)(1)-(2)	7485(b)
1242(a)	6601(c)
1243(a)	6227(e)
1246(a)	706(c)(2)(A)
1246(b)	706(c)(2)
1251(a)(1)	857(a)(2)-(3)
1251(a)(2)	857(f)-(g)
1251(b)(1)	856(k)
1251(b)(2)	856(a)(6)
1252(a)	856(d)(2)(C)
1252(b)	856(d)(7)
1253	856(d)(5)
1254(a)	857(b)(3)(D)-(E)
1254(b)(1)	857(b)(7)(A)(i)
1254(b)(2)	852(b)(3)(D)(iii)
1255(a)(1)-(3)	856(c)(3)-(8)
1255(b)(1)	856(c)(5)(G)
1255(b)(2)	857(b)(5)
1255(b)(3)	857(b)(6)(C)
1256	857(d)(3)
1257(a)(1)	856(e)(2)
1257(a)(2)(A)-(B)	856(e)(3)
1257(b)	856(e)(5)
1257(c)	856(e)(4)

Act Sec.	Code Sec.	Act Sec.	Code Sec.
1258	856(c)(5)(G)	1416(b)(2)	5044
1259	857(e)(2)(B)-(D)	1417(a)	5384(b)(2)(D)
1260	857(b)(6)(C)(iii)	1418(a)	5053(g)
1261(a)	856(j)(4)-(5)	1419(a)	5053(h)
1261(b)	856(j)(5)(A)(ii)	1420(a)	5055
1262	856(i)(2)	1421(a)	5418
1271(a)	851(b)(2)-(4)	1422(a)	5364
1271(b)(1)(A)-(B)	851(b)(3)	1431(a)(1)-(2)	4222(b)(2)
1271(b)(2)	851(c)	1432(a)	4051(d)-(e)
1271(b)(3)	851(d)	1432(b)(1)	4495
1271(b)(4)	851(e)(1)	1432(b)(1)	4496
1271(b)(5)	851(e)(4)	1432(b)(1)	4497
1271(b)(6)	851(g)-(h)	1432(b)(1)	4498
1271(b)(7)	851(g)(3)	1432(c)(1)	4681(b)(1)(B)-(C)
1271(b)(8)(A)-(B)	817(h)(2)(A)-(B)	1432(c)(2)	4682(g)
1271(b)(9)	1092(f)(2)	1433(a)	4161(b)
1281(a)	6652(g)	1434(a)	4052(e)-(f)
1281(b)	6652(k)	1434(b)(1)	4052(d)
1281(c)	6683	1434(b)(2)	4052(g)
1281(d)	7519(f)(4)(A)	1435(a)	4261(h)-(i)
1282(a)	6512(b)(3)	1435(b)	4041(c)(2)
1283(a)	6103(h)(5)-(6)	1436(a)	4091(d)
1283(b)	6103(p)(4)	1436(b)	6416(d)
1284(a)	6501(a)	1441	148(f)(4)(B)(ii)(I)
1285(a)	7430(f)(3)	1442	148(f)(4)(C)(xvii)
1285(b)	7430(b)(5)	1443	148(d)(3)
1285(c)(1)-(2)	7430(f)(2)	1444(a)	148(c)(2)(B)-(E)
1301(a)	6019(1)-(3)	1444(b)	148(f)(4)(E)
1302(a)	2207A(a)(2)	1451(a)	6512(b)(2)
1302(b)	2207B(a)(2)	1451(b)	6512(b)(4)
1304(a)	2105(b)(2)-(4)	1452(a)	7481(c)
1305(a)	646	1453(a)	7430(c)(4)(D)
1305(b)	2652(b)(1)	1454(a)	7436
1306(a)	663(b)	1454(a)	7437
1306(b)	663(b)(2)	1454(b)(1)	6511(d)(7)
1307(a)(1)-(2)	663(c)	1454(b)(2)	7421(a)
1307(b)	663(c)	1454(b)(3)	7453
1308(a)	267(b)(11)-(13)	1454(b)(3)	7481(b)
1308(b)	1239(b)(2)-(3)	1461(a)	6655(g)(3)
1309(a)	685	1463(a)	6621(c)(2)(B)(iii)
1310(a)	2035	1501(a)	402(g)(9)
1311(a)	2056(b)(7)(C)	1501(b)	408(p)(8)
1312(a)	2056A(c)(3)	1502(b)	401(a)(13)(C)-(D)
1313(a)	2032A(d)(3)	1504(a)(1)	403(b)(3)
1314(a)	2056A(a)(1)(A)	1505(a)(1)	401(a)(5)(G)
1401(a)	4003(a)(3)(C)	1505(a)(2)	401(a)(26)(H)
1401(a)	4051(b)(2)(B)	1505(a)(3)	410(c)(2)
1402(a)	4051(e)	1505(b)	401(k)(3)(G)
1402(b)	4052(b)(1)(B)(ii)-(iv)	1505(c)	403(b)(12)(C)
1411(a)	5008(c)(1)	1506(a)(1)	409(h)(2)(B)
1412(a)	5175(c)	1506(a)(2)(A)-(B)	409(h)(2)
1413(a)	5207(c)	1506(b)(1)(A)	4975(f)(6)
1414(a)	5222(b)(2)	1506(b)(1)(B)(i)-(ii)	4975(d)
1414(b)	5053(f)	1507(a)	4972(c)(6)(B)
1414(b)	5053(i)	1521(a)(A)[1]-(B)[2]	412(c)(7)
1414(c)(1)-(2)	5056(c)-(d)	1521(c)(1)	412(b)(2)(C)-(E)
1415(a)	5115	1521(c)(3)(A)	412(c)(7)(D)(i)-(iii)
1415(b)(1)	5681(a)	1522(a)(1)-(2)	414(e)(5)
1415(b)(2)(A)-(B)	5681(c)	1523(a)	512(e)(3)
1416(a)	5044(a)	1525(a)(1)-(2)	401(k)(7)(iii)-(v)
1416(b)(1)	5361	1526(a)	415(n)

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1526(b)	415(k)(3)	1601(d)(2)(C)(i)-(ii)	404(a)(3)(A)(i)-(ii)
1527(a)	415(b)(2)(G)	1601(d)(2)(D)	401(k)(11)(B)(iii)
1528(a)	101(h)	1601(d)(3)	401(m)(11)
1530(a)	664(d)(1)(C)	1601(d)(6)(A)	414(e)(5)(A)
1530(c)(5)	664(d)(2)(B)	1601(d)(6)(B)	403(b)(1)(A)(i)-(iii)
1530(a)	664(d)(2)(C)	1601(d)(7)	414(q)(7)
1530(b)	664(g)	1601(e)	956(b)(1)(A)
1530(c)(1)	401(a)(1)	1601(f)(1)(A)	30A
1530(c)(2)	404(a)(9)(C)	1601(f)(1)(C)	55(c)(1)
1530(c)(3)	415(c)(6)	1601(f)(2)(A)	9503(c)(2)(A)(ii)
1530(c)(4)(A)-(B)	415(e)(6)-(7)	1601(f)(2)(B)	9503(e)(5)(A)
1530(c)(5)	664(d)(1)(B)	1601(f)(3)(A)(i)-(ii)	4001(f)
1530(c)(6)	674(b)(4)	1601(f)(3)(B)	4001(g)
1530(c)(7)(i)[A]-(iii)[C]	2055(a)(3)-(5)	1601(f)(4)(A)(i)-(ii)	4041(l)
1530(c)(8)	2056(b)(8)	1601(f)(4)(B)	4041(a)(2)
1530(c)(9)	4947(b)(4)	1601(f)(4)(C)	4092(b)
1530(c)(10)	4975(e)(7)	1601(f)(4)(D)	4261(g)
1530(c)(11)(A)-(B)	4978(a)	1601(f)(5)(A)	593(e)(1)(A)
1530(c)(12)(A)-(B)	4978(b)(2)	1601(f)(5)(B)	1374(d)(7)
1530(c)(13)	4978(c)	1601(f)(6)(A)	860L(b)(1)(A)
1530(c)(14)	4978(e)(2)	1601(f)(6)(B)	860L(d)(2)
1530(c)(15)	4979A(a)	1601(f)(6)(C)	860L(e)(2)(B)
1530(c)(16)	4979A(c)	1601(f)(6)(D)	860L(e)(3)(A)
1530(c)(17)	4979A(d)-(e)	1601(f)(6)(E)(i)	860L(e)(3)(D)
1531(a)(2)	9831	1601(f)(6)(E)(ii)	860L(e)(2)(A)
1531(a)(2)	9832	1601(h)(1)(A)	529(e)(1)(B)
1531(a)(2)	9833	1601(h)(1)(B)	529(e)(1)(C)
1531(a)(4)	9811	1601(h)(2)(A)	23(a)(2)
1531(a)(4)	9812	1601(h)(2)(B)	23(b)(2)(B)
1531(b)(1)(A)	9801(c)(1)	1601(h)(2)(C)	137(b)(1)
1531(b)(1)(B)	9831(b)	1601(h)(2)(D)(i)	414(n)(3)(C)
1531(b)(1)(C)	9831(c)(1)	1601(h)(2)(D)(ii)	414(t)(2)
1531(b)(1)(D)	9831(c)(2)	1601(h)(2)(D)(iii)	6039D(d)(1)
1531(b)(1)(E)	9831(c)(3)	1601(i)(1)	6048(b)
1531(b)(2)(A)	4980D(a)	1601(i)(2)	679(a)(3)(C)(ii)-(iii)
1531(b)(2)(B)	4980D(c)(3)(B)(i)(I)	1601(i)(3)(A)	7701(a)(30)(E)(ii)
1531(b)(2)(C)	4980D(d)(1)	1601(i)(3)(B)	641(b)
1531(b)(2)(D)	4980D(d)(3)	1602(a)(1)	26(b)(2)(N)-(P)
1531(b)(2)(E)	4980D(f)(1)	1602(a)(2)	220(c)(3)(A)-(D)
1532(a)	9802(c)	1602(a)(3)	220(d)(2)(C)
1601(a)(1)	6050R(c)(1)	1602(a)(4)	6693(a)
1601(b)	52(c)	1602(a)(5)	4975(c)(4)
1601(c)(1)	1361(e)(1)(B)(i)-(iii)	1602(b)	7702B(c)(2)(B)
1601(c)(3)	1361(b)(3)(A)	1602(c)	162(l)(2)(B)
1601(c)(4)(A)	512(e)(2)	1602(d)(1)	6050Q(b)(1)
1601(c)(4)(B)	1361(c)(6)-(7)	1602(d)(2)(A)	6724(d)(2)(Q)-(Y)
1601(c)(4)(C)	1361(b)(1)(B)	1602(d)(2)(B)	6652(e)
1601(c)(4)(D)	512(e)(1)	1602(e)	7702B(g)(4)(B)(ii)-(iii)
1601(d)(1)(A)	408(i)	1602(f)(1)	264(a)(4)
1601(d)(1)(B)	408(k)(6)(H)	1602(f)(2)	264(d)(2)(B)(ii)
		1602(f)(3)	264(d)(4)(B)
1601(d)(1)(C)(i)(I)-(II)	408(l)(2)(B)	1602(g)(1)	877(d)(2)(B)
		1602(g)(2)	877(d)(2)(D)
1601(d)(1)(C)(ii)(I)-(II)	6693(c)(2)	1602(g)(3)	877(d)(3)
		1602(g)(4)(A)-(C)	877(d)(4)(A)
1601(d)(1)(D)	408(p)(8)[(9)]	1602(g)(5)	2501(a)(3)(C)
1601(d)(1)(E)	408(p)(2)(D)(i)	1602(g)(6)(A)	2107(c)(2)(B)(i)
1601(d)(1)(F)	408(p)(2)(D)(iii)	1602(g)(6)(B)	2107(c)(2)(C)
1601(d)(1)(G)	408(p)(5)	1602(h)(1)	6039G
1601(d)(2)(A)	401(k)(11)(D)(ii)	1602(h)(3)	877(e)(1)
1601(d)(2)(B)	401(k)(11)(E)	1603(a)	4962(b)

Act Sec.	Code Sec.	Act Sec.	Code Sec.
1603(b)(1)(A)	6033(b)(10)	1604(c)(1)	168(j)(6)
1603(b)(1)(B)	6033(b)(10)(C)	1604(d)(1)	1059(d)(3)
1603(b)(2)	6033(b)(11)	1604(d)(2)(A)(i)-(ii)	833(b)(1)(A)
1604(a)(1)	263(a)(1)(F)-(H)	1604(e)(1)	267(f)(4)
1604(a)(2)(A)-(B)	312(k)(3)(B)	1604(g)(1)	163(j)(2)(B)(iii)
1604(a)(3)	1245(a)(2)(C)	1604(g)(2)	665(d)(1)
1604(a)(3)	1245(a)(3)(C)	1604(g)(3)	1441(g)
1604(b)(1)	6621(a)(1)	1604(g)(4)	2523(g)(1)
1604(b)(2)(A)	412(m)(5)(E)(ii)(II)	1604(g)(5)	9502(d)(5)-(6)

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4006(b)(1)	4973(d)	9302(h)(1)(B)	5761(c)-(e)
4006(b)(2)	220(b)	9302(h)(1)(C)	5761(a)
4041(a)	501(o)-(p)	9302(h)(1)(D)	5761(d)
4631(c)(2)	6103(l)(12)(F)	9302(h)(1)(E)(i)	5754
5405(a)(1)-(3)	3309(b)(3)(D)-(F)	9302(h)(2)(A)	5712
5406(a)(1)-(3)	3306(c)(19)-(21)	9302(h)(2)(A)	5713(a)
5407(a)(1)-(2)	3309(b)(1)	9302(h)(2)(A)	5721
5514(a)(1)	51(d)(9)	9302(h)(2)(A)	5722
5514(a)(1)	6103(l)(10)	9302(h)(2)(A)	5762(a)(1)
5514(a)(1)	6103(p)(4)	9302(h)(2)(A)	5763(b)-(c)
5514(a)(1)	6402(a)	9302(h)(2)(B)	5763(b)
5514(a)(1)	6402(e)-(j)	9302(h)(3)	5701(c)
9302(a)(1)-(2)	5701(b)	9302(h)(4)	5702(k)
9302(b)(1)-(2)	5701(a)	9302(h)(5)	5712(1)-(3)
9302(c)	5701(c)	11024(b)(1)	6103(l)(16)
9302(d)	5701(d)	11024(b)(2)	6103(a)(3)
9302(e)(1)-(2)	5701(e)	11024(b)(3)	6103(i)(7)(B)(i)
9302(f)	5701(f)	11024(b)(4)	6103(p)(3)(A)
9302(g)(1)	5701(g)-(h)	11024(b)(5)	6103(p)(4)
9302(g)(2)	5702(p)	11024(b)(6)	6103(p)(4)(F)(i)
9302(g)(3)(A)	5702(c)	11024(b)(7)(A)-(F)	6103(p)(4)(F)
9302(g)(3)(B)(i)-(ii)	5702(d)	11024(b)(8)	7213(a)(2)

Taxpayer Browsing Protection Act of 1997

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2(b)	7213(a)	3(d)(1)	7431(d)
3(a)(1)-(2)	7431(a)(1)-(2)	3(d)(2)	7431(c)(1)(B)(ii)
3(b)	7431(e)-(g)	3(d)(3)	7431(f)
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1(h)	301, 302, 303	58	417
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15	1294	59(a)(3)[4]	907
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55(e)	525	137	157
56	417	137(b)(1)	125
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Introduction: Taxpayers Affected

TAXPAYER RELIEF ACT OF 1997

Overview

¶ 65

Broad range of taxpayers impacted.—Billed as "taxpayer relief" and representing the biggest tax cut since 1981, the Taxpayer Relief Act of 1997 provides significant tax breaks to individuals and small businesses primarily at the expense of corporations and persons subject to excise and FUTA taxes. The basic structure of the new legislation holds closely to the five-year projections in the original budget agreement—$135 billion in tax cuts and $50 billion in revenue increases, for a net tax cut of $85 billion. However, some additional tax reductions were thrown in for good measure that were due, in part, to better-than-anticipated increases in government receipts and reductions in the deficit. As a result, the final five-year tally was $151 billion in tax cuts and $56 billion in revenue raisers, including a controversial tobacco tax increase that was inserted into companion legislation, for a net tax cut of $95 billion.

Certainly, for investors, the cornerstone of the new law is the reduction in individual capital gains rates from 28 percent to 20 percent (10 percent for those in the 15-percent tax bracket). This represents the first significant decrease in the tax rates applicable to capital gains or ordinary income since 1986. The capital gains tax cut (which applies not only to investors but also to unincorporated business) is significant both for the fact of the reduction and also for the planning opportunities that the capital gains-ordinary income tax rate differential will offer. However, like many other changes in the Taxpayer Relief Act, capital gains reduction adds an additional layer of complexity to the Internal Revenue Code and moves a step further away from the tax simplification reforms of 1986. Aside from the capital gains provisions, however, Congress appears to have compounded the problem of complexity by its propensity for creating programs that are identifiable to the public as new benefits when the same effect might have been achieved by working with the existing statutory provisions. Labels such as "HOPE Credit," "Lifetime Learning Credit," "Child Tax Credit," and "Roth IRA" are probably designed as much for the campaign trail as for the tax code.

Although individuals will undoubtedly derive financial benefits from these and other provisions, their long-term reaction may well be frustration and confu-

sion. The legislation provides choices that taxpayers may find difficult to sort through. When is a qualified tuition program better than an education IRA? Does one put an extra $2,000 into a deductible IRA account or a nondeductible, but potentially tax free, Roth IRA? With many of these provisions directed at middle-income taxpayers, it appears that professional assistance will become increasingly important in making the most of the available opportunities.

Small businesses and the self-employed also have gained from the Act, securing a variety of tax benefits for which they actively lobbied, including an alternative minimum tax (AMT) exemption for small corporations and a 100-percent deduction for health insurance for the self-employed that will be phased in over a period of years. Large corporations will not find much to cheer about (with the notable exception of AMT changes), but should be grateful that the original budget proposals from the Clinton Administration were largely left at the legislative wayside.

One way of measuring the significance of any particular provision is to look at its impact on revenues. Based on the overall estimated cost to the federal coffers over the initial five-year period following enactment, the Child Tax Credit has the greatest impact, at an estimated cost of $85 billion, followed by the HOPE and Lifetime Learning Credits at $31 billion, the AMT adjustments for depreciation at $7 billion, and the changes in the estate and gift tax unified credit and expanded IRAs, at $6 billion each. Yet the measure of importance of expanded IRAs and capital gains rate reduction should not be confined to these five-year projections. Expanded IRAs are not expected to show their true revenue drain until tax-free earnings are distributed outside of the five-year period. Similarly, the capital gains rate reduction for the first few years should show a revenue increase as investors cash in their profits earlier than expected, but there will be revenue losses in the long run. Thus, looking at the 10-year projections, the order changes a bit. The Child Tax Credit and education credits remain the most costly benefits at $183 billion and $76 billion, respectively. The IRA changes come next at $34 billion, the unified credit changes follow at $33 billion, and the capital gains changes make the list at $21 billion.

An increase in the airline ticket tax and the cigarette tax, and an extension of the FUTA surtax account for the lion's share of the new revenue.

IMPACT ON TAXPAYERS

Effect on Families

¶ 68

Education, retirement, estate tax, home ownership, and health care relief.—The Taxpayer Relief Act is, without a doubt, "family friendly." The general cost of raising children is addressed through the Child Tax Credit (¶ 119). The fully phased-in credit is $500 for each child under age 17. However, when adjusted gross income (AGI) reaches $110,000 ($75,000 for those filing as single taxpayers or as heads-of-households) a credit phaseout is triggered. Other pro-family provisions make it easier to finance an education, buy or sell a home, and pay for health care. New retirement savings incentives are provided. The tax package also includes significant estate tax relief.

Education. The numerous educational incentives contained in the Taxpayer Relief Act may create a new financial planning specialty area. Taxpayers can put education savings into a tax-favored education IRA (¶ 145) or a qualified state-

sponsored tuition program (¶ 149). Deductible IRAs, with expanded income limits (¶ 172), and nondeductible Roth IRAs (¶ 166) allow taxpayers to make penalty-free withdrawals for education purposes (¶ 174). Once the college years arrive, taxes can be reduced not only with tax-favored withdrawals from the selected investment vehicles but also with the HOPE Credit for the first two years of college (¶ 139), the Lifetime Learning Credit for later years (¶ 139), a deduction for student loan interest (¶ 157), and utilization of the exclusion for employer-provided educational assistance (¶ 156). Another provision allows forgiveness of student loans sponsored by tax-exempt charitable organizations in return for taking certain public service jobs (¶ 159).

Retirement. Provisions that could make the retirement years a bit more "golden" expand the income eligibility range for deductible IRAs (¶ 172), create new nondeductible, but potentially tax-free, Roth IRAs (¶ 166), and allow spouses to contribute $2,000 to a deductible IRA even if they are married to active participants in pension plans (¶ 173). An additional provision helpful to those with substantial pension assets is the repeal of the excise tax on excess accumulations and distributions (¶ 714). On the planning side, decisions must now be made regarding whether an investment strategy using capital gains works best separately or within a tax-deferred retirement-type plan.

Estate Planning. Several key provisions assist families in estate planning. The phased-in increase in the unified credit will permit a husband and wife, upon the conclusion of a phase-in period and with proper planning, to exclude up to $2 million ($1 million each) from their taxable estates or from taxable lifetime gifts (¶ 201). For a married couple with a qualified family-owned business, the exclusion could total $2.6 million ($1.3 million each) starting in 1998 (¶ 215). Cost-of-living adjustments will be made to a number of dollar limitations, including the $10,000 annual gift tax exclusion (¶ 204). A more detailed list of law changes in the estate and gift tax area appears at ¶ 86.

Home Ownership. Home ownership is encouraged by the provision allowing for penalty-free distributions from individual retirement plans in connection with the purchase of a first home (¶ 177). Also, the new law provides a generous $500,000 exclusion for gain from the sale of a home, which can be claimed as often as every two years (¶ 129). The exclusion is $250,000 for taxpayers who do not file jointly and replaces the rollover provisions of Code Sec. 1034 and the $125,000 gain exclusion that could previously be claimed by taxpayers age 55 or older.

Health Care. The tobacco tax increase in the Balanced Budget Act of 1997, which was passed by Congress in tandem with the Taxpayer Relief Act, will finance expanded health coverage for some children who have no health insurance. Self-employed individuals will also benefit from an increased deduction for their health insurance costs (¶ 863). In addition, eligible seniors may be able to participate in a pilot program that would allow them to pay medical expenses using amounts contributed to "MedicarePlus Choice Medical Savings Accounts" (MSAs) (¶ 817).

Effect on Investors

¶ 70

Capital gains and other provisions affecting investors.—A provision that is of primary interest to individual investors is the reduction in the capital gains tax rate. Although a reduced capital gains rate is applicable (20 percent generally, 10 percent for individuals in the 15-percent bracket), the long-term

capital gains holding period has been increased from one year to 18 months (¶ 301, 302). If an asset is held for five years, the 20-percent and 10-percent rates are cut an additional two percent to 18 percent and eight percent, respectively. Special rules apply in determining the starting date of the five-year holding period (¶ 303). The maximum 28-percent rate continues to apply to capital gains on dispositions of assets that are held more than a year and not more than 18 months. Significantly, the new capital gains rates will not cause taxpayers to become liable for the alternative minimum tax (AMT)—the reduced rates may be used to compute AMT liability (¶ 303). Collectibles are ineligible for the new, favorable capital gains tax rates (¶ 303).

Although proposed modifications to the rules providing a 50-percent exclusion for gain from the sale of qualifying small business stock did not make it into the final law, a provision permitting the rollover of gain from the sale of qualified small business stock if other small business stock is timely purchased was included (¶ 306), opening up an entire new market for venture capital. Traders in securities and dealers in commodities and financial products other than securities have been given the option of electing mark-to-market treatment (¶ 341). The deduction for contributions of appreciated stock to private foundations was also retroactively reinstated and extended for one more year (¶ 105).

On the negative side, investors will likely be adversely affected by additional limitations on tax-free contributions of property to investment companies (¶ 509). Deferral of capital gains will be hampered by restrictions on the use of "selling short against the box" and "equity swap" techniques, unless such positions are closed out within 30 days after the end of the tax year (¶ 308-310). Gains or losses on the lapse, cancellation, expiration, or other termination of a right are treated as capital in nature. This closes a loophole that allowed taxpayers to structure transactions in ways that converted capital losses into ordinary losses (¶ 307).

Effect on Small Businesses

¶ 72

Provisions affecting small businesses.—Small businesses won many of the provisions that they battled to obtain. One significant exception was a simplified safe-harbor for gaining independent contractor status, which was removed from the bill during final negotiations. The deduction for health insurance expenses of self-employed individuals, however, will be increased incrementally from 40 percent to 100 percent over a nine-year phase-in period that ends in the year 2007 (¶ 863). Another small business victory effectively overturns the U.S. Supreme Court's decision in *N.E. Soliman*, 93-1 USTC ¶ 50,014) by broadening the availability of the home office deduction in situations where an office is used for administrative and management functions (¶ 109). Family-owned businesses receive a new exclusion from estate and gift taxes that is generally equal to the difference between $1.3 million and the standard estate tax exclusion for the year in question (¶ 215).

The legislation exempts corporations with average annual gross receipts of less than $5 million from the alternative minimum tax (¶ 525), thereby reducing both tax and tax-compliance costs, and also allows these businesses a three-year carryback period for the portion of a net operating loss (NOL) attributable to a Presidentially declared disaster (¶ 315). Otherwise, the Act generally reduces the NOL carryback period from three years to two years for corporate and noncorporate taxpayers. The carryforward period, however, is increased from 15

years to 20 years. The three-year carryback period for NOLs attributable to Presidentially declared disasters also applies to individuals.

The imposition of penalties for the failure of a small business to make electronic funds transfers of tax payments has been delayed until after June 30, 1998 (¶ 1040). Matching contributions on behalf of self-employed individuals to a 401(k) plan or a SIMPLE IRA are not treated as elective contributions and, therefore, are not taken into account in determining whether contributions to the plan exceed the applicable elective contribution limit for the tax year (¶ 729).

Effect on Individuals

¶ 74

Provisions affecting individual taxpayers.—Many of the provisions that affect families and investors are targeted at individuals. In the area of education, funds deposited in a deductible IRA (¶ 145) or in the nondeductible Roth IRA (¶ 166) may be available for penalty-free withdrawals if used for continuing education (¶ 174). The Lifetime Learning Credit (¶ 139), the deduction for student loan interest (¶ 157), and the exclusion for employer-provided educational assistance (¶ 156) may all aid individuals in paying for continuing education expenses. Another provision allows for the tax-free forgiveness of student loans made by tax-exempt charitable organizations provided that the recipients take certain public service jobs (¶ 159).

Retirement-planning possibilities are enhanced by the expanded income eligibility ranges for deductible IRAs (¶ 172) and the new nondeductible Roth IRAs (¶ 166), as well as by the repeal of the penalty tax on excess accumulations and distributions (¶ 714). In the estate planning area, the unified credit equivalent will gradually increase to $1 million (¶ 201), and the $10,000 annual gift tax exclusion, as well as other estate and gift tax limits, will now be adjusted for inflation (¶ 204). Also made available by the legislation are new MedicarePlus Choice Medical Savings Accounts (¶ 817-829).

The capital gains tax rates applicable to individuals are reduced and the holding periods for capital assets are lengthened (¶ 301-302). Capital gains rates also apply for AMT purposes (¶ 303). Home ownership is tax favored through the allowance of penalty-free distributions from IRAs for first-time homebuyers (¶ 177) and a $250,000 exclusion for single filers ($500,000 for joint filers) on the sale of a home (¶ 129), replacing the Code Sec. 1034 rollover provisions and the over-age-55 exclusion rules.

Some other provisions that impact on individual taxpayers include:

Authorizing the payment of taxes by any commercially acceptable means, including credit cards (¶ 1111).

Raising the charitable mileage rate to 14 cents per mile (¶ 107).

Modifying the estimated tax safe harbors (¶ 1103).

Increasing the *de minimis* threshold for estimated tax payments (¶ 1101).

Waiving estimated tax penalties attributable to Act changes (¶ 1105).

Tightening of earned income credit (EIC) compliance (¶ 127).

Expanding Social Security information collection for tax-enforcement purposes (¶ 1053).

Retaining a three-year carryback period for casualty and theft losses (¶ 315).

Abating interest on tax underpayments by taxpayers in Presidentially declared disaster areas in 1997 (¶ 1009).

Using appraisals to establish disaster losses (¶ 103).

Allowing tax benefits with respect to mortgage financing for residences located in disaster areas (¶ 349).

Increasing the foreign earned income exclusion (¶ 133).

Effect on Businesses Generally

¶ 76

Provisions affecting businesses.—The following provisions in the new tax law have a general impact on business, whether corporations, partnerships, or proprietorships:

Alternative minimum tax depreciation adjustments (¶ 527).

Extension of the research tax credit (¶ 317), the work opportunity credit (¶ 318), and employer-provided educational assistance (¶ 156).

Restrictions on the use of the income forecast method (¶ 325).

Depreciation allowed for rent-to-own property (¶ 325).

Expansion of the requirement that involuntarily converted property be replaced with property acquired from an unrelated person (¶ 334).

Restrictions on deductions with respect to company-owned life insurance (¶ 845).

Modification of NOL carryforward and carryback rules (¶ 315).

New credit for wages paid to welfare recipients (¶ 320).

Extension of the temporary FUTA surtax rate (¶ 1120).

Limitation on the carryback period for general business credits; extension of the carryforward period (¶ 321).

Shrinkage allowance for inventory accounting, with safe harbor for retailers (¶ 340).

Modification of look-back method for long-term contracts (¶ 338).

Employers permitted to offer parking or cash equivalent (¶ 131).

Exclusion for construction allowances provided to lessees (¶ 322).

Exception from the installment sale rules for property sales by a manufacturer to a dealer (¶ 343).

Clarification of the *de minimis* fringe benefit rules with respect to no-charge employee meals (¶ 332).

Gratuitous transfers made for the benefit of employees (¶ 284).

Denial of an interest deduction with respect to disqualfied debt instruments (¶ 513).

Exclusion extended to assignment of workers' compensation liability (¶ 347).

Appraisals may establish amounts of disaster losses (¶ 103).

Effect on Corporations

¶ 78

Reorganizations and other provisions affecting corporations.—Corporations as a specific group did not fare well under the Act. Instead of reaping tax benefits, corporations are the object of many of the revenue-raising provisions. Nevertheless, the Act did give corporations tax relief primarily in the form of a change in the AMT depreciation adjustment. This change (which also applies to noncorporate taxpayers) conforms the depreciation period used for AMT purposes to the period used for regular tax purposes (¶ 527). Another helpful provision increases the filing thresholds for information returns concerning the ownership of foreign corporations (¶ 990).

Among the corporate provisions with a negative impact is the requirement that gain be recognized on spin-offs of corporate assets followed by a tax-free merger of the spin-off company outside of the corporate group—"Morris Trust" transactions (¶ 503). Another provision taxes certain extraordinary dividends in response to what is commonly referred to as the Seagrams transaction (¶ 501).

Other corporate provisions include:

A tightening of the holding period that is applicable for purposes of claiming the dividends-received deduction (¶ 517).

Tax treatment of redemptions involving related corporations (¶ 505).

Registration and other provisions relating to confidential corporate tax shelters (¶ 1058).

Treatment of certain preferred stock as boot (¶ 507).

Scope of investment company assets increased for purposes of determining whether property transfers result in gain recognition (¶ 509).

Certain notices disregarded under a provision increasing the interest rate on large corporate underpayments (¶ 1108).

Effect on Partnerships and Other Flow-Through Entities

¶ 80

Provisions affecting partnerships and other flow-through entities.—A number of important changes impact partnerships. There are a series of provisions that deal with reporting by large partnerships, reporting by foreign partnerships, and simplification issues. Among the more significant provisions are new rules concerning basis allocation of properties distributed by a partnership (¶ 403), elimination of the substantial appreciation requirements for inventory of a partnership (¶ 410), and an extension of the time limit for taxing precontribution gain (¶ 407).

Other partnership provisions include:

Limitations imposed on tax-free contributions to investment partnerships (¶ 509).

Grandfathered publicly traded partnerships may elect not to be taxed as corporations and, instead, pay a publicly traded partnership tax (¶ 401).

Imposition of a one-year moratorium on the issuance of Treasury regulations with respect to the self-employment taxes of limited partners (¶ 463).

Simplified flow-through reporting system established for electing large partnerships (¶ 412-420).

Simplified audit procedures created for large partnerships (¶ 421-430).

Due date set for furnishing information to partners of large partnerships (¶ 430).

Returns to be provided on magnetic media by partnerships with 100 or more partners (¶ 469).

Filing threshold modified for IRA with interest in partnership items (¶ 183).

Changes relating to TEFRA partnership proceedings (¶ 431-461).

Partnership tax year closed with respect to deceased partner (¶ 465).

Information reporting requirements modified with respect to foreign partnerships (¶ 971, 981-990).

Regulations to address determination of partnerships' foreign or domestic status (¶ 467).

Other pass-through provisions include:

Clarification of the statute of limitations for pass-through entities (¶ 1013).

Rules clarified regarding employee stock ownership plans (ESOPs) of S corporations (¶ 752).

Unrelated business income tax (UBIT) rules inapplicable to ESOPs of S corporations (¶ 755).

Effect on Tax-Exempt Organizations

¶ 82

Provisions affecting tax-exempt organizations.—Two provisions are of particular interest to tax-exempt organizations. One is the modification of the control test and the addition of attribution rules used to determine the UBIT consequences of certain payments of passive income received from subsidiaries of tax-exempt organizations (¶ 613). Another provision that will affect fund-raising clarifies the treatment of sponsorship payments (¶ 611).

Other provisions that impact on tax-exempt organizations include:

Modifications of qualified state tuition programs (¶ 149).

Repeal of the limitation on qualified 501(c)(3) bonds other than hospital bonds (¶ 353).

Denial of interest paid deduction with respect to certain tax-exempt obligations (¶ 513).

UBIT rules inapplicable to ESOPs of S corporations (¶ 755).

Purchases of receivables by tax-exempt hospital cooperative service organizations (¶ 605).

Clarification of tax-exempt status of certain state workers' compensation funds (¶ 601).

Repeal of the $100,000 limitation on unspent proceeds of tax-exempt bond issues under one-year rebate exception (¶ 355).

Exception from rebate requirement applies to earnings on bond proceeds invested in bona fide debt service funds (¶ 356).

Debt service-based limitation on investment in certain nonpurpose investments repealed (¶ 357).

Repeal of expired provisions relating to student loan bonds (¶ 358).

Extension of tax-favored treatment for contributions of appreciated stock to private foundations (¶ 105).

Extend due date for first-quarter estimated tax by private foundations (¶ 623).

Allow timeshare associations to be treated as homeowner associations (¶ 616).

Provide a FUTA exemption for certain religious schools (¶ 1129).

Repeal exceptions from the rules applicable to certain exempt organizations that provide commercial-type insurance (¶ 607).

Effect on Foreign Activities

¶ 84

Provisions affecting foreign taxpayers and investors.—Many changes were made in the foreign area—few were major in and of themselves, but together they make a considerable impact on many foreign operations. Changes affect the treatment of controlled foreign corporations (CFCs) (¶ 932-942), ease the transfer of assets to foreign entities (¶ 968-969), simplify the foreign tax credit (FTC) limitation for individuals (¶ 904), modify the passive foreign investment company (PFIC) provisions to eliminate overlap with Subpart F and to allow for mark-to-market elections (¶ 944-948), and impose new information reporting requirements on foreign partnerships and corporations (¶ 981-990).

Other provisions with an impact on the foreign area include:

Foreign sales corporation (FSC) benefits for computer software (¶ 950).

Increase in the dollar limitation on the exclusion for income earned abroad (¶ 133).

Translation of foreign taxes simplified (¶ 901).

Exception to AMT foreign tax credit limit repealed (¶ 910).

Holding period imposed for crediting foreign taxes associated with foreign-source dividends (¶ 917).

Election to use a simplified AMT foreign tax credit limitation available (¶ 907).

Interest on underpayments reduced by FTC carrybacks (¶ 924).

Determination of limitations period relating to FTCs clarified (¶ 922).

Treatment of personal transactions in foreign currency simplified (¶ 953).

Principal office requirement repealed for foreign entities trading in stock or securities (¶ 955).

Definition of foreign personal holding company income expanded (¶ 936).

Restrictions imposed on like-kind exchanges involving foreign personal property (¶ 336).

FTC limitation for financial services income clarified (¶ 912).

FTC limitations for dividends received from 10/50 companies simplified (¶ 915).

Duty-free treatment under General System of Preferences extended (¶ 993).

Limitation imposed on treaty benefits for transactions involving hybrid entities (¶ 992).

Exceptions from definition of U.S. property apply to certain security positions (¶ 940).

Service income of nonresident aliens earned on foreign ships treated as foreign-source income (¶ 965).

Estate and gift tax treatment of short-term original issue discount (OID) instruments held by nonresident aliens clarified (¶ 212).

Excise tax replaced by recognition of gain on certain transfers to foreign entities (¶ 968).

Transition rule on definition of trust residency applies to certain trusts (¶ 973).

Clarification of authority to withhold Puerto Rico income taxes from salaries of federal employees (¶ 1132).

Miscellaneous clarifications apply to post-1986 foreign taxes deemed paid (¶ 919).

FTC limitation category for financial services income clarified (¶ 912).

Effect on Estate and Gift Tax Planning

¶ 86

Provisions affecting estate and gift taxation.—Among the important provisions affecting estate and gift tax planning are the increases in the unified credit, including exclusions for family-owned businesses and conservation easements (¶ 201, 214, 215), cost-of-living adjustments to such key figures as the annual gift tax exclusion (¶ 204), and modifications to the interest rates charged on deferred payments (¶ 227).

Other provisions affecting estate and gift taxes include:

Extension of treatment of certain rents to lineal descendants (¶ 229).

Judicial review of eligibility for a payment extension (¶ 225).

Statute of limitations on the revaluation of gifts for estate tax purposes (¶ 255).

Repeal of throwback rules for domestic trusts (¶ 275).

Expansion of generation-skipping transfer tax exception applicable to individuals with deceased parents (¶ 249).

Treatment of certain revocable trusts as part of estate (¶ 261).

Limitation on annual payouts of charitable remainder trusts (¶ 281).

Consistency requirement for returns of estate and trust beneficiaries (¶ 273).

Exemption for charitable gifts exceeding $10,000 from gift tax filing requirements (¶ 253).

Waiver of certain rights of recovery of estate tax from qualified terminable interest property (QTIP) trusts clarified (¶ 243).

Transitional rules provided for qualified domestic trusts (QDOTs) (¶ 233).

Estate and gift tax treatment clarified for short-term OID instruments held by nonresident aliens (¶ 212).

65-day rule applies to estate distributions (¶ 264).

Separate share rules available to estates (¶ 267).

Estate and beneficiaries treated as related persons for loss disallowance purposes (¶ 270).

Special tax treatment available for funeral trusts (¶ 286).

Adjustments apply to certain gifts made within three years of decedent's death (¶ 210).

Treatment of survivor annuities under qualified terminable interest rules clarified (¶ 239).

QDOT rules apply to forms of ownership that are not trusts (¶ 235).

Authority to waive requirement of U.S. trustee for QDOTs granted (¶ 237).

Effect on Pensions and Employee Benefits

¶ 88

Provisions affecting pensions and employee benefits.—Changes in the pension and employee benefits area fall mainly into the simplification category. A figure that has been around for a number of years—the maximum amount that can be in a pension plan before an employer is prevented from doing an involuntary cash-out—is increased from $3,500 to $5,000 (¶ 706). Another significant provision is the permanent repeal of excess distribution and excess accumulation taxes (¶ 714).

Other provisions that impact on pensions and employee benefits include:

Increase in full-funding limit (¶ 717, 719).

Modification of minimum funding requirements for bus company plans (¶ 721).

Required diversification of plan investments (¶ 727).

Exemption of police and firefighters from Code Sec. 415 dollar limitations (¶ 764).

Exclusion for disability benefits received by certain police and firefighters (¶ 135).

Exclusion for survivor benefits with respect to police officers killed in the line of duty (¶ 137).

Trust's status unaffected by gratuitous transfers for the benefit of employees (¶ 284).

Exclusion for employer-provided parking (¶ 131).

Prohibited transactions excise tax increased (¶ 712).

Basis recovery rules apply to amounts received as an annuity (¶ 781).

Matching contributions for self-employed individuals not treated as elective deferrals (¶ 729).

Plans not disqualified merely due to acceptance of rollover contributions (¶ 701).

Prohibition on assignment or alienation modified (¶ 703).

Paperwork burdens on plans eliminated (¶ 708).

Guidance to address new technologies in retirement plans (¶ 710).

Modifications to Code Sec. 403(b) exclusion allowance to conform to Code Sec. 415 modifications (¶ 776).

Ten-percent tax on nondeductible plan contributions modified (¶ 725).

Permanent moratorium on nondiscrimination rules for governmentally sponsored pension plans (¶ 758).

Filing threshold modified for IRA with interest in partnership items (¶ 183).

UBIT rules inapplicable to ESOPs of S corporations (¶ 755).

Rules clarified regarding ESOPs of S corporations (¶ 752).

Plan amendment effective dates clarified (¶ 790).

Special rules provided for church plans (¶ 766-768).

Tax provisions cover maternity stay and mental health parity rules (¶ 865).

Portability and permissible service credits under government pension plans defined (¶ 760).

Irrigation and drainage districts eligible to maintain 401(k) plans (¶ 731).

Effect on Special Environmental and Economic Development Zones

¶ 90

Provisions relating to environmental and economic development.—Provisions on additional empowerment zones (¶ 371), designation of new empowerment zones (¶ 372), and incentives for education zones (¶ 161) were added to the tax legislation during the final negotiations. Tax incentives were also included for revitalizing the District of Columbia (¶ 381-387).

Other provisions relating to environmental and economic development issues include:

Estate and gift tax treatment of land subject to a qualified conservation easement (¶ 214).

Expensing Brownfields redevelopment costs in empowerment zones, enterprise communities, and EPA demonstration sites (¶ 330).

Modification of empowerment zone and enterprise community criteria in the event of future designations of additional zones and communities (¶ 373, 379).

Volume cap inapplicable to enterprise zone facility bonds with respect to new empowerment zones (¶ 377).

Eligibility criteria for designation of future enterprise zones in Alaska and Hawaii modified (¶ 375).

Leaking underground storage tank trust (LUST) fund taxes reinstated (¶ 1251).

Effect on IRS Procedures and Practices

¶ 92

Provisions affecting IRS procedures.—Penalties and civil damages for unauthorized inspection of taxpayer information were enacted in the Taxpayer Browsing Protection Act (P.L. 105-35) signed by the President on the same day as the Taxpayer Relief Act ('97 TRA) (¶ 1004, 1007). Another provision with a more widespread impact—this one in the '97 TRA—now authorizes the IRS to accept payment of taxes by any commercially acceptable means (¶ 1111).

Other provisions in the '97 TRA relating to IRS procedures and practices include:

Modification of the levy exemption and allowance for a continuous levy on certain payments (¶ 1019, 1022).

Allowable disclosures of return information (¶ 1046).

Use of appraisals to establish disaster loss valuation (¶ 103).

Reporting of certain payments made to attorneys (¶ 1052).

Clarification of procedure for administrative cost awards (¶ 1016).

Study required on simplified collection of distilled spirit taxes (¶ 1277).

Demonstration study of combined federal and state employment tax reporting by Montana taxpayers (¶ 1064).

Abatement of interest on tax underpayments by taxpayers in Presidentially declared disaster areas in 1997 (¶ 1009).

Allowable return information disclosures for purposes of administering certain Veteran's Administration programs (¶ 1043).

Threshold for reporting payments to corporations performing services for federal agencies decreased (¶ 1055).

Deductible gifts to charities in excess of $10,000 exempt from gift tax filing requirements (¶ 253).

Consistency requirements apply to returns of beneficiaries of estates and trusts (¶ 273).

Simplified flow-through reporting requirements formulated for electing large partnerships (¶ 412-420).

Simplified audit procedures apply to large partnerships (¶ 421-430).

Due date set for furnishing information to partners of large partnerships (¶ 430).

Return filing using magnetic media required for partnerships with 100 partners or more (¶ 469).

Reasonable-cause exception provided for penalties (¶ 1001).

Period for filing claims for refunds clarified (¶ 1010).

Authority to disclose whether a prospective juror has been audited repealed (¶ 1070).

Statute of limitations for pass-through entities clarified (¶ 1013).

IRS authorized to grant exemption from excise tax registration requirements (¶ 1290).

Provisions governing TEFRA partnership proceedings (¶ 431-461).

Partnership tax year closed with respect to deceased partner (¶ 465).

Jurisdiction of Tax Court clarified with respect to overpayment determinations (¶ 1025).

Tax Court jurisdiction clarified with respect to interest determinations (¶ 1028).

Tax Court jurisdiction expanded for independent contractors (¶ 1031).

Application of net worth requirements for award of administrative costs clarified (¶ 1034, 1037).

Due date extended for first-quarter estimated tax payments of private foundations (¶ 623).

Authority to withhold Puerto Rico income taxes from salaries of federal employees clarified (¶ 1132).

Certain notices disregarded for purposes of liability for increased interest rate on large corporate underpayments (¶ 1108).

Restrictions imposed on application of EIC (¶ 127).

Expanded accessibility of Social Security Administration records for use in tax enforcement (¶ 1053).

Federal information sharing allowed for verification of benefit determinations (¶ 1047).

Disclosure of return information relating to Medicare status permitted (¶ 1049).

Effect on Specific Industries

¶ 94

Provisions affecting specific industries.—The following is a listing of specialized industries affected by the Taxpayer Relief Act of 1997.

Automobiles, trucks, and truck drivers

Airlines and airplanes

Railroads and intercity transportation

Securities and financial products

Insurance

Real estate

Real estate investment trusts (REITs)

Regulated investment companies (RICs)

Farms and farm services

Health care

Technology

Chemicals, drugs, and vaccines

Oil, gas, minerals, kerosene, ethanol, methanol, alternative fuels, and home heating

Tobacco

Beer, wine, and beverages

Telephone card issuers

Homeowner associations

Churches

Governmental entities and employees

Law enforcement and safety officers

Automobiles, trucks, and truck drivers

Increased deductibility of business meal expenses for individuals subject to federal hours of service rules (¶ 111).

Transfer of motor fuel taxes from general trust to highway trust fund (¶ 1223).

Exemption from Code Sec. 280F luxury tax and depreciation limits for incremental cost of clean-fuel vehicles and increased limits for electric vehicles (¶ 327).

Increased thresholds to exempt cost of electric and other clean-fuel motor vehicles from luxury auto tax (¶ 1247).

Exemption from truck excise tax for certain wrecked truck repairs and truck modifications (¶ 1233).

Replacement of registration requirement for tax-free sales of trucks for resale (¶ 1236).

Increase of *de minimis* threshold for imposing excise tax on after-market alterations of heavy trucks and luxury cars (¶ 1241, 1245).

Replacement of exclusion of tire value from truck sales price with tax credit for excise tax paid on tires (¶ 1239).

Airlines and airplanes

Extension and modification of taxes funding the Airport and Airway Trust Fund (¶ 1201).

Increased deductibility of business meal expenses for individuals subject to federal hours of service rules (¶ 111).

Clarification of tax treatment of skydiving flights as noncommercial aviation (¶ 1221).

Elimination of double taxation for certain purchases of aviation fuel from fixed-based operators (¶ 1227).

Railroads and intercity transportation

Enhanced net operating loss carryback rule for Amtrak (¶ 565).

Increased deductibility of business meal expenses for individuals subject to federal hours of service rules (¶ 111).

Modify funding for bus company pension plans (¶ 721).

Securities and financial products

Appreciated financial positions subject to constructive sale treatment (¶ 308-310).

Option to use mark-to-market method for dealers in commodities and for traders in securities or commodities (¶ 341).

Capital gain and loss treatment extended to certain terminations of a right or obligation with respect to real and nonactively traded personal property (¶ 307).

Clarification of foreign tax credit limitation for financial services income (¶ 912).

Clarification of worker classification of representatives of securities brokers (¶ 1114).

Denial of interest deduction on certain debt instruments (¶ 513).

Determination of original issue discount (OID) where pooled debt obligations are subject to acceleration (¶ 345).

Exception from "U.S. property" definition for certain securities transactions (¶ 940).

Estate and gift tax treatment of short-term OID instruments held by nonresident aliens (¶ 212).

Insurance

Special rules for exempt organizations providing commercial-type insurance repealed (¶ 607).

Modification of treatment of company-owned life insurance (¶ 845).

Extension of exclusion for personal injury liability assignments to workers' compensation liability (¶ 347).

Modification of adjusted current earnings (ACE) adjustment for AMT purposes for certain property and casualty insurance companies (¶ 529).

Clarification of exemption from self-employment tax for certain termination payments received by former insurance salesmen (¶ 1117).

Real estate

Exclusion for construction allowances provided to lessees (¶ 322).

Depreciation for rent-to-own properties (¶ 325).

Real estate investment trusts (REITs)

Monetary penalties for failure to determine ownership (¶ 539).

De minimis rule for tenant services income (¶ 541).

Attribution rules applicable to tenant ownership and independent contractor status (¶ 543).

Credit for tax paid by REIT on retained capital gains (¶ 545).

Repeal of 30-percent gross income test (¶ 547).

Modification of ordering rule for distributions of earnings and profits from non-REIT year (¶ 549).

Treatment of foreclosure property, grace period (¶ 551).

Payments under hedging instruments (¶ 553).

Excess noncash income definition expanded (¶ 555).

Prohibited transaction safe harbor, involuntary conversions (¶ 557).

Shared appreciation mortgages, bankruptcy safe harbor rule (¶ 559).

Wholly owned subsidiaries, definition modified (¶ 561).

Regulated investment companies (RICs)

Repeal of 30-percent gross income test, "short-short" rule (¶ 535).

Farms and farm services

Family-owned business estate and gift tax exclusion (¶ 215).

Income averaging for farmers (¶ 361).

Termination of use of suspense accounts for family farm corporations required to change from cash method to accrual method (¶ 365).

Cash-method farmers use of installment method for AMT purposes (¶ 363).

Tax treatment of livestock sold on account of certain weather-related conditions (¶ 367).

Estate and gift tax treatment of land subject to a qualified conservation easement (¶ 214).

Health care

Treatment of hospitals that participate in provider-sponsored organizations (¶ 606).

MedicarePlus Choice medical savings accounts, pilot program (¶ 817-829).

Purchases of receivables by tax-exempt hospital cooperative service organizations (¶ 605).

Technology

Foreign sales corporation benefits for computer software companies (¶ 950).

Contributions of computer technology and equipment for elementary and secondary school purposes (¶ 519).

Rollover of gain from the sale of one qualified small business stock to replacement stock (¶ 306).

Chemicals, drugs, and vaccines

Permanent extension of orphan drug credit (¶ 319).

Uniform rate of tax on vaccines (¶ 1255).

Application of excise tax on imported recycled Halon-1211 (¶ 1248).

Oil, gas, minerals, kerosene, ethanol, methanol, alternative fuels, and home heating

Suspend certain net income limitations with respect to percentage depletion for marginal producers (¶ 326).

Tax kerosene in the same manner as diesel fuel (¶ 1211).

Treat certain gasoline retailers as wholesale distributors for gas tax refund purposes (¶ 1219).

Tax alternative fuels, except compressed natural gas (CNG), according to gas fuel equivalency (¶ 1216).

Eliminate double taxation for certain purchases of aviation fuel from fixed-based operators (¶ 1227).

Repeal excise tax on recreational motorboat diesel fuel (¶ 1209).

Tobacco

Increase tobacco excise tax (¶ 1257, 1258).

Beer, wine, and beverages

Codify Bureau of Alcohol, Tobacco, and Firearms regulations on wine labeling (¶ 1283).

Reduce excise tax rate on draft hard cider to small producer beer rate (¶ 1276).

Require study on simplified collection of distilled spirit taxes (¶ 1277).

Allow credit or refund for imported bottled distilled spirits returned to distilled spirits plant (¶ 1271).

Authority to cancel export bonds without submission of records regarding exportation of distilled spirits (¶ 1272).

Repeal required maintenance of records on premises of distilled spirits plant (¶ 1273).

Permit fermented material from any brewery to be received at a distilled spirits plant (¶ 1274).

Repeal requirement that wholesale dealers in liquors post sign (¶ 1275).

Refund of tax on domestic wine returned to bond not limited to unmerchantable wine (¶ 1280).

Allow use of additional ameliorating material in certain wines (¶ 1281).

Tax-free withdrawal of domestically produced beer for use at foreign embassies (¶ 1286).

Tax-free withdrawals of beer from breweries for destruction (¶ 1285).

Authority to allow drawback on exported beer with proof of exportation (¶ 1287).

Imported wine transferred in bulk to winery withdrawable without payment of tax (¶ 1282).

Transfer of beer imported in bulk to brewery without payment of tax (¶ 1288).

Telephone card issuers

Apply telephone excise tax to certain prepaid phone cards (¶ 1253).

Homeowner associations

Allow timeshare associations to be taxed as homeowner associations, and modify the definition of "property" for timeshare purposes (¶ 616).

Churches

Special rules for church pension plans (¶ 766-768).

FUTA exemption for certain religious schools (¶ 1129).

Governmental entities and employees

District of Columbia reforms (¶ 381-387).

Modifications of qualified state tuition programs (¶ 149).

Irrigation and drainage districts eligible to maintain 401(k) plans (¶ 731).

Modification of portability of permissible service credits under government pension plans (¶ 760).

Allow advance refunding of Virgin Islands bonds (¶ 351).

Above-the-line deduction for expenses of certain state and local officials compensated on a fee basis (¶ 117).

Permanent moratorium on nondiscrimination rules for public pension plans (¶ 758).

Treatment of certain reimbursed expenses of rural mail carriers (¶ 113).

Treatment of travel expenses of certain federal employees engaged in criminal investigations (¶ 115).

Clarification of authority to withhold Puerto Rico income taxes from salaries of federal employees (¶ 1132).

FUTA exemption for election workers (¶ 1123).

FUTA exemption for inmates (¶ 1126).

Law enforcement and safety officers

Exempt police and firefighters from Code Sec. 415 dollar limitations on retirement benefits (¶ 764).

Survivor benefits attributable to death of a public safety officer in the line of duty excludable from taxable income (¶ 137).

Exclusion for certain disability benefits paid to former police officers or fire fighters in connection with heart disease or hypertension treated as work-related illness (¶ 135).

Chapter 1

Individuals

DEDUCTIONS

Standard Deduction for Dependents

¶ 101

Background

Prior to the Taxpayer Relief Act of 1997, the standard deduction for an individual who could be claimed as a dependent on another taxpayer's return was limited to the lesser of:

(1) the standard deduction for a single taxpayer (projected to be $4,250 for 1998); or

(2) the greater of:

Background

(a) $500 (the inflation-adjusted amount is projected to be $700 for 1998), or

(b) the dependent's earned income.

Increased standard deduction for employed dependents.—The new law increases the basic standard deduction for a taxpayer who may be properly claimed as a dependent on another person's tax return and who has earned income in excess of $250 but total income of less than the standard deduction amount. As amended, the basic standard deduction equals the *lesser* of:

(1) the standard deduction for single taxpayers (projected to be $4,250 for 1998); or

(2) the greater of:

(a) $500 (the inflation-adjusted amount is projected to be $700 for 1998); or

(b) the individual's earned income, plus $250.

The Taxpayer Relief Act of 1997 added the $250 amount to the dependent's earned income, effectively increasing the basic standard deduction by $250 for taxpayers claiming regularly employed dependents. The $250 amount is indexed for inflation after 1997.

Example. Eddie Junior, age 17, has $400 of interest income and $1,500 of earned income in 1998. Because Junior is eligible to be claimed by his parents as a dependent (and assuming that the $500 statutory amount increases to $700 for 1998), his standard deduction is $1,750: the greater of $700, or $1,500 earned income + $250.

PRACTICAL ANALYSIS. Joe Guterl, of counsel, Woolson, Sutphen, Anderson & Nergaard, Somerville, N.J., observes that a classic example of a dependent for whom a dependency exemption is allowed on another taxpayer's return is the college student whose parents claim the student as a dependent. The $250 increase in the standard deduction will provide some relief for working students who have managed to maintain some savings. For example, take a student who earned $4,000 over the summer, and who has also saved some money now in a savings account or mutual fund. This year, the student will likely pay tax on the few dollars of interest or other earnings from the bank account or mutual fund. (This is because his standard deduction is equal to the $4,000 the student earned—the student's interest from the bank account or earnings from the mutual fund usually end up being subject to tax). Next year, under the new law, the student's earnings from his investments (up to $250) will not be subject to income tax because the standard deduction will be the $4,000 earned over the summer plus the interest or other earnings. For the many students whose savings and investments generate $250 or less, this means they will not have to pay taxes (although the student may have to

file a return to get a refund for taxes withheld from the summer wages).

Effective date. The increased standard deduction for dependents applies to tax years beginning after December 31, 1997.

Act Sec. 1201(a)(1), amending Code Sec. 63(c)(5); Act Sec. 1201(a)(2), amending Code Sec. 63(c)(4); Act Sec. 1201(c). Law at ¶ 5039. Committee Report at ¶ 12,115.

Appraisals to Establish Disaster Loss

¶ 103

Background

Disaster losses are deductible only if the taxpayer establishes the amount of the loss. Regulations permit taxpayers to value the amount of loss using either an appraisal or the cost of repairs. Both of these methods have proven problematic for taxpayers coping with a recent disaster. Arranging for an appraisal is yet another task for an already burdened taxpayer, and there are a number of valuation problems particular to disaster situations. The cost of repairs method is easier to use, but the IRS may challenge the amount spent years after the repairs are completed.

Appraisals used for government loans can value disaster loss.—The new law states that the IRS is not prohibited from issuing guidance or other rules allowing an appraisal used to secure a loan or loan guarantee from the federal government to be used to establish the amount of a disaster loss for tax purposes. Should the IRS authorize a new valuation method, it would apply only in a presidentially declared disaster area.

This provision clears the way for the IRS to accept documentation prepared to secure a disaster loan from the Federal Emergency Management Agency (FEMA) as proof of the amount of a disaster loss. Although FEMA processes disaster relief loans, the actual lender is the Small Business Administration (SBA). In the course of making these loans, the SBA inspects the damage and appraises the amount needed for repairs. The Loss Verification Report (LVR) separates deductible repairs from nondeductible repairs, and taxpayers should find that basing disaster loss deductions on LVRs is far simpler than the currently available methods.

Effective date. The appraisal provision is effective on August 5, 1997.

Act Sec. 912(a), adding Code Sec. 165(i)(4); Act Sec. 912(b). Law at ¶ 5071. Committee Report at ¶ 10,590.

Stock Contributed to Private Foundations

¶ 105

Background

The amount of charitable deduction available for contributions of property to private foundations (other than certain private operating foundations) is generally limited to the taxpayer's basis in the property. However, taxpayers were entitled to deduct the fair market value of appreciated, publicly traded stock donated to

Background

private foundations before June 1, 1997, provided the stock would have generated capital gain, rather than ordinary income, to the donor.

Deduction for contributions of appreciated stock to private foundations extended through June 30, 1998.—The deduction for the fair market value of qualified appreciated stock contributed to private foundations is retroactively extended through June 30, 1998. The provision had expired on May 31, 1997.

Only publicly traded stock that is capital gain property is eligible for the deduction.

Effective date. The extension applies to contributions made after May 31, 1997.

Act Sec. 602(a), amending Code Sec. 170(e)(5)(D)(ii); Act Sec. 602(b). Law at ¶ 5077. Committee Report at ¶ 10,440.

Charitable Mileage Rate

¶ 107

Background

When Congress first authorized a charitable contribution deduction for taxpayers who use their own automobiles in volunteer work performed for charities, the statutory charitable standard mileage rate was set at 12 cents per mile. The rate has remained unchanged since it became effective, for tax years beginning after 1984.

Deduction for charitable mileage increased.—The new law increases the deduction for individuals who use their passenger automobiles in volunteer work for qualified charities to 14 cents per mile. The 14 cents per mile charitable standard mileage rate will not be indexed for inflation.

In spite of the increase from 12 cents to 14 cents per mile, the ratio between the charitable mileage rate and the business mileage rate (31.5 cents per mile in 1997) remains greater than it was in 1985 when standard mileage rates were first available. In 1985, the business use of a car generated a deduction of 21 cents per mile (for the first 15,000 miles of business use), while charitable use garnered a deduction of 12 cents per mile. Only if the charitable mileage rate had been raised to 18 cents would the 1985 ratio have been approximated.

Effective date. The increase in the mileage rate applies to tax years beginning after December 31, 1997.

Act Sec. 973(a), amending Code Sec. 170(i); Act Sec. 973(b). Law at ¶ 5077. Committee Report at ¶ 10,895.

EMPLOYEE AND SELF-EMPLOYED BUSINESS EXPENSES

Home Office Deduction

¶ 109

Background

A taxpayer may deduct the expenses of maintaining a home office (e.g., a portion of rent or depreciation, utilities, and repairs). However, stringent conditions are imposed on the deduction. A home office deduction is allowed only for the portion of a home that is used exclusively and regularly:

(1) as the taxpayer's principal place of business;

(2) as a place used to meet with customers, clients or patients in the normal course of the taxpayer's trade or business; or

(3) in the taxpayer's trade or business if the portion used is a separate structure not attached to the dwelling unit.

If the taxpayer is an employee, a deduction is allowed only if the home office is maintained for the convenience of the employer.

In 1993, the U.S. Supreme Court restrictively defined the term "principal place of business" as the place where a taxpayer performed "the essence of the professional service" (*N.E. Soliman,* 93-1 USTC ¶ 50,014). It used this definition to deny home office deductions to an anesthesiologist who performed the administrative and management functions of his practice in his home office (bookkeeping, correspondence, reading medical journals, and communicating with surgeons, patients and insurance companies), but practiced medicine at various hospitals.

Principal place of business clarified; Supreme Court's decision in *Soliman* overturned.—One way expenses incurred in connection with a home office are deductible is where the expenses are allocable to a portion of a dwelling unit that is exclusively used on a regular basis as the taxpayer's "principal place of business." The new law expands the definition of "principal place of business." A home office qualifies as a taxpayer's principal place of business under the Act if:

(1) the office is used by the taxpayer to conduct administrative or management activities of the taxpayer's trade or business; and

(2) there is no other fixed location of the trade or business where the taxpayer conducts substantial administrative or management activities of the trade or business.

With this provision, Congress effectively overturned the U.S. Supreme Court's decision in *N.E. Soliman* (93-1 USTC ¶ 50,014). In *Soliman,* the Court defined an individual's principal place of business as the place where the primary income-generating functions of the trade or business were performed.

Planning Note. The expanded definition of a principal place of business will enable many taxpayers to deduct the cost of traveling to and from their homes to other locations at which they conduct business (under Rev. Rul. 94-47, 1994-2 CB 18). Under prior law, these travel costs were often classified as nondeductible commuting expenses.

Caution. The expanded definition of a taxpayer's principal place of business does not affect the requirement that home office expenses are deductible only if the office is used by the taxpayer exclusively on a regular basis as a place of business. Also, if the taxpayer is an employee, the taxpayer's use of the home office must be for the convenience of the employer.

PRACTICAL ANALYSIS. Sidney Kess, New York, CCH contributing editor, author and lecturer, observes that the liberalization of the home office deduction rules will make deductibility of home office expenses more widespread. Sole proprietors that use a home office for scheduling appointments, ordering supplies, doing research, or keeping their books will be able to deduct home office expenses as long as there is no other fixed location for such administrative or management activities. However, the new rules may not be any help to employees who choose to work at home where employers make space available to them somewhere else because they may not meet the "convenience of the employer" test that remains unchanged.

If a taxpayer does not meet the new definition, the taxpayer may be entitled to a home office deduction under the current principal place of business exception, or one of the other tests of Code Sec. 280A.

Application of the expanded principal place of business test. Taxpayers who perform administrative or management activities for their trade or business at places other than the home office are not automatically prohibited from taking the deduction. The House Committee Report clarifies that the following taxpayers are not prevented from taking a home office deduction under the new definition:

(1) taxpayers who do not conduct substantial administrative or management activities at a fixed location other than the home office, even if administrative or management activities (e.g., billing activities) are performed by other people at other locations;

(2) taxpayers who carry out administrative and management activities at sites that are not fixed locations of the business (e.g., cars or hotel rooms) in addition to performing the activities at the home office;

(3) taxpayers who conduct an insubstantial amount of administrative and management activities at a fixed location other than the home office (e.g., occasionally doing minimal paperwork at another fixed location); and

(4) taxpayers who conduct substantial *non*administrative and *non*management business activities at a fixed location other than the home office (e.g., meeting with, or providing services to customers, clients or patients at a fixed location other than the home office).

There is no other fixed location where the taxpayer conducts substantial administrative or management activities if the taxpayer does not *actually* perform such functions at a fixed location other than the home office. In other words, the second prong of the new definition of "principal place of business" can be met regardless of whether the taxpayer chose to perform administrative and management functions at home even though another fixed location was available. However, employees do not have this flexibility; the fact that other space for administrative activities at a fixed location was available to an employee is

relevant to determining whether the home office use was for the convenience of the employer.

New definition restores home office deductions to thousands of small business owners. Under the *Soliman* definition, many taxpayers who performed significant business functions outside their home offices were considered to have no principal place of business even though they managed their business activities from their homes, and were denied any deduction for their home office expenses and were often denied related travel expenses. Affected professionals included doctors (who perform their primary duties in hospitals), salespeople (who spend time visiting their customers' offices), teachers (who also practice their disciplines as a business), and house painters and other tradespeople (who spend much of their time at job sites).

Numerous policy arguments have been made in favor of restoring the home office deduction to pre-*Soliman* levels. The expanded definition puts small businesses on a more equal footing with larger businesses that lease space and may deduct rent. The deduction is perceived as pro-family, helps cut down on commuting, and conserves energy. It also recognizes advances in technology that encourage operating a home-based business, provides a financial boost to these businesses, and helps create jobs.

Effective date. The new definition applies to tax years beginning after December 31, 1998.

Act Sec. 932(a), amending Code Sec. 280A(c)(1); Act Sec. 932(b). Law at ¶ 5107. Committee Report at ¶ 10,660.

Business Meal Expenses

¶ 111

Background

Only 50 percent of the cost of ordinary and necessary business meals are deductible as business expenses. A higher deduction is allowed for food and beverages provided to crew members of certain vessels and offshore oil and gas platforms and drilling rigs. These exceptions to the 50-percent deduction limit are made because there is little chance that meals eaten by these employees have a personal component and there is little chance for abuse of the deduction. Under prior law, no exception was provided for workers in the transportation industry.

Increased deduction for meals provided to employees subject to DOT hours of service limitations.—The deductible percentage of the cost of meals consumed by employees subject to Department of Transportation (DOT) hours of service rules will gradually increase over the next 10 years from the currently allowable 50 percent of otherwise deductible meal expenses to 80 percent. This increase is intended to restore meal deductions to certain workers who are forced to eat away from home and are unlikely to abuse the deduction.

The increased meal deduction is available for food or beverages consumed while away from home by an individual during, or incident to, a period of duty subject to the DOT's hours of service limitations. Individuals subject to the hours of service limitations include:

(1) certain air transportation employees, such as pilots, crew, dispatchers, mechanics, and control tower operators;

(2) interstate truck operators and interstate bus drivers;

(3) certain railroad employees, such as engineers, conductors, train crews, dispatchers, and control operations personnel; and

(4) certain merchant mariners.

Deduction percentage. The increase in the deductible percentage is phased in as follows:

Tax years beginning in:	*Deductible percentage:*
1998, 1999	55
2000, 2001	60
2002, 2003	65
2004, 2005	70
2006, 2007	75
2008 and after	80

Effective date. The increased percentage applies to tax years beginning after December 31, 1997.

Act Sec. 969(a), adding Code Sec. 274(n)(3); Act Sec. 969(b). Law at ¶ 5103. Committee Report at ¶ 10,875.

Rural Mail Carriers

¶ 113

Background

Under a special provision enacted by the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647), employees of the U.S. Postal Service who furnished their own vehicles for the collection and delivery of mail on rural routes were allowed to compute the deduction for the business use of their cars using a standard mileage rate greater than that provided to other taxpayers. This rate, 150 percent of the standard mileage rate, applied to all business miles driven while performing qualified services. Rural mail carriers covered by collective bargaining agreements are also paid an equipment maintenance allowance (EMA) that, prior to the enactment of the Taxpayer Relief Act of 1997, had to be taken into account in computing the allowable automobile deduction. If the EMA exceeded the carrier's automobile expense deduction, the excess was includible in income. If the EMA was less than the allowable deduction, a deduction was allowable only to the extent that this shortfall (excess of allowable deduction over EMA), when combined with the taxpayer's other miscellaneous itemized deductions, exceeded two percent of the taxpayer's adjusted gross income.

Rural mail carriers' receipt of qualified reimbursements deemed equal to expenses.—The treatment of certain reimbursed expenses of rural mail carriers has been simplified by the Taxpayer Relief Act of 1997. Under the Act, a rural mail carrier who receives a qualified reimbursement of expenses incurred for the use of his vehicle for performing the collection and delivery of mail on a rural route is allowed a deduction for an amount equal to the qualified reimbursement received. This reimbursement is treated as an amount paid under an accountable plan under Code Sec. 62(a)(2)(A) and, accordingly, is excluded from gross income. The Act repeals the special standard mileage rate and the provisions related to its use by rural mail carriers that were enacted by the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647).

Qualified reimbursement. A qualified reimbursement is defined as amounts paid by the United States Postal Service to employees as an equipment maintenance allowance under the 1991 collective bargaining agreement between the Postal Service and the National Rural Mail Carriers' Association. Amounts paid as an equipment maintenance allowance by the U.S. Postal Service under later collective bargaining agreements that supersede the 1991 agreement are also considered qualified reimbursements so long as the amounts do not exceed the amounts that would have been paid under the 1991 agreement, as adjusted for changes in the Consumer Price Index (as defined in Code Sec. 1(f)(5)) since 1991.

Effective date. The provision is effective for tax years beginning after December 31, 1997.

Act Sec. 1203(a), redesignating former Code Sec. 162(o) as Code Sec. 162(p), and adding a new Code Sec. 162(o); Act Sec. 1203(b), repealing Act Sec. 6008 of the Technical and Miscellaneous Revenue Act of 1988; Act Sec. 1203(c). Law at ¶ 5067. Committee Report at ¶ 12,130.

Federal Employees Engaged in Criminal Investigations

¶ 115

Background

Under current law, travel expenses paid or incurred in connection with temporary employment away from home are deductible. A taxpayer who is away from home in a single location for more than one year is considered to be indefinitely, not temporarily, employed and, therefore, may not deduct travel expenses incurred in connection with this employment. If a taxpayer's employment away from home in a single location lasts less than one year, the employment is considered temporary or indefinite depending on the facts and circumstances. Prior to the Taxpayer Relief Act of 1997, these rules also applied to federal employees away from home in connection with services performed while investigating a federal crime.

Traveling expenses of federal employees engaged in criminal investigations.—Travel expenses paid or incurred in connection with temporary employment are deductible, while those associated with indefinite employment are generally not deductible. A taxpayer is considered indefinitely employed if he is away from home in a single location for one year or more. If the taxpayer is employed in a single location for less than one year, the employment is considered temporary (and the expenses incurred or paid are deductible) or indefinite (and the expenses incurred are not deductible) based on the facts and circumstances. The Act eliminates the temporary versus indefinite determination in the case of unreimbursed travel expenses incurred by federal employees who are investigating or who are providing support services for investigating a federal crime. In order to qualify under this special provision, the employee must be certified by the Attorney General or his delegate as traveling on behalf of the United States on temporary duty status to investigate or provide support services for the investigation of a federal crime. If the federal employee meets these requirements, travel expenses incurred are fully deductible, regardless of the length of the period for which certification is given, so long as the other requirements for deductibility under Code Sec. 162 are met.

Effective date. The provision is effective for amounts paid or incurred with respect to tax years ending after August 5, 1997.

Act Sec. 1204(a), amending Code Sec. 162(a); Act Sec. 1204(b). Law at ¶ 5037. Committee Report at ¶ 12,135.

State and Local Government Employees

¶ 117

Background

Expenses incurred in the performance of services as an employee may not be deducted to determine adjusted gross income (AGI) (above-the-line deduction). These expenses are deductible "below-the-line" as miscellaneous itemized deductions, subject to the two-percent of AGI floor. Employee business expenses are also not allowed in determining alternative minimum taxable income. Prior to the Taxpayer Relief Act of 1997, no exception to these rules existed for state and local government officials compensated on a fee basis.

"Above-the-line" deduction for state and municipal employees.—Expenses paid or incurred with respect to services performed by an official as an employee of a State or local government are deductible in computing adjusted gross income (AGI). This "above-the-line" deduction applies provided that the official is compensated in whole or in part on a fee basis. These expenses are also deductible for alternative minimum tax (AMT) purposes.

Planning Note. Due to the retroactive nature of this provision, effective for tax years after 1986, taxpayers may be able to file amended returns for open tax years to deduct these expenses. It is important to keep in mind that this deduction reduces AGI which, in turn, may affect other items with AGI-related thresholds, such as medical expenses, casualty losses and miscellaneous itemized deductions.

Effective date. The provision applies to expenses paid or incurred in tax years beginning after December 31, 1986.

Act Sec. 975(a), adding Code Sec. 62(a)(2)(C); Act Sec. 975(b). Law at ¶ 5037. Committee Report at ¶ 10,920.

TAX CREDITS

Child Tax Credit

¶ 119

Background

Generally, taxpayers may claim a personal exemption for each dependent child ($2,650 in 1997). The exemption is indexed for inflation and phased out for higher-income taxpayers. Additionally, taxpayers may claim a credit for dependent care expenses, which is also phased out for higher-income taxpayers. However, prior to the Taxpayer Relief Act of 1997, taxpayers were not allowed a credit based solely on the number of dependent children they had.

Allowance of credit.—Taxpayers who have qualifying children under age 17 are entitled to the new child tax credit. The amount of the credit will be $400 per child in 1998, increasing to $500 per child in 1999 and thereafter.

The credit is allowed only for tax years consisting of 12 months.

Limitation of credit based on AGI. The child credit begins to phase out when modified adjusted gross income (AGI) reaches $110,000 for joint filers, $55,000 for marrieds filing separately, and $75,000 for singles. The credit is reduced by $50 for each $1,000, or fraction thereof, of modified AGI above the thresholds. Thus, the level at which the child tax credit is completely phased out depends on the number of qualifying children.

Planning Note. In 1998, for taxpayers with one child, the child credit is completely phased out when modified AGI exceeds $117,001 for joint filers, $62,001 for marrieds filing separately, and $82,001 for singles.

These thresholds are not indexed for inflation. For phaseout purposes, modified AGI is determined without regard to the exclusions from gross income for foreign earned income and foreign housing costs (Code Sec. 911) and income of residents of Guam, American Samoa, the Northern Mariana Islands, and Puerto Rico (Code Secs. 931 and 933).

Qualifying child. A "qualifying child" is a child, descendant, stepchild, or eligible foster child for whom the taxpayer may claim a dependency exemption and who is less than 17 years old. The age limitations apply to the child's age as of the close of the tax year. The child must be a U.S. citizen.

Refundable amount of child credit. Taxpayers who qualify for the child tax credit may qualify for a refundable credit known as the supplemental credit. Taxpayers who have three or more qualifying children may also be entitled to an additional credit.

Amount of supplemental credit. The supplemental credit is treated as a component of the earned income credit (EIC). The supplemental child credit equals:

(1) the lesser of:

(a) $500 ($400 in 1998) times the number of qualifying children, or

(b) the taxpayer's regular tax liability (net of all applicable credits except the EIC) over the taxpayer's tentative minimum tax (determined without regard to the alternative minimum tax foreign tax credit); over

(2) the taxpayer's regular income tax liability (net of all applicable credits other than the EIC), plus the employee share of FICA (and one-half any SECA tax liability), less the amount of the EIC.

Planning Note. Generally, a supplemental credit will result only when the taxpayer's EIC exceeds the taxpayer's employee share of FICA (and one half of any SECA tax liability).

Amount of child credit for three or more children. If the taxpayer has three or more qualifying children, the maximum amount of the child credit for a tax year cannot exceed the greater of:

(1) the excess of the taxpayer's regular tax liability (net of applicable credits other than the EIC) over the taxpayer's tentative minimum tax liability (determined without regard to the alternative minimum tax foreign tax credit); or

(2) the excess of the sum of the taxpayer's regular income tax liability (net of applicable credits other than the EIC) and the employee share of FICA (and one-half any SECA tax liability), less the amount of the EIC.

The portion of the credit determined under (2) that exceeds the amount determined under (1) is treated as a refundable credit. The portion of the credit determined under (1) that exceeds the credit determined under (2) is treated as a supplemental credit.

These two rules operate to ensure that a taxpayer with more than two children who claims the EIC will first be able to take the full amount of the EIC, including the refundable portion. If any portion of the EIC is refundable, then the taxpayer is allowed a refundable credit of the portion of the child credit that does not exceed the employee's share of FICA taxes paid by the taxpayer over the refunded EIC. In other words, a taxpayer is allowed a refundable credit to the extent that the FICA exceeds the refunded EIC.

PRACTICAL ANALYSIS. Lee Schwendner, Tax Manager at Dennis Nelson & Company, Ltd., Rolling Meadows, Illinois, observes that some taxpayers who fall below the adjusted gross income threshold may still find the benefit of this new credit to be diminished. The benefit may be reduced if the taxpayer is subject to alternative minimum tax. The credit will only provide a benefit to the extent that regular tax liability exceeds the alternative minimum tax.

Taxpayers who anticipate being in an alternative minimum tax situation may benefit from watching the timing of alternative minimum tax adjustments and preferences. Since the child tax credit is first available in 1998, a potential shift of preference items from 1998 to 1997 (when the credit does not apply) may help preserve a credit for 1998 which otherwise would have been reduced because of alternative minimum tax in 1998.

It should also be noted that since the ability to claim this credit follows the dependency deduction for the qualifying child, certain divorce and multiple support agreement situations will be impacted. A divorced custodial parent who has waived the dependency exemption for a child will now also be passing the potential credit to the other parent. This can make the dependency exemption a slightly higher bargaining chip in divorce agreements.

In some divorce situations, the traditional logic of passing the dependency exemption to the higher income parent may now be reversed. If one parent would expect to be over the Code Sec. 24 adjusted gross income limit, it may be beneficial to give the dependency exemption to the lower income party. Depending on the spread between income tax rates of the two parties, it may be possible to obtain the maximum tax savings by putting the exemption with the lower income taxpayer because the larger credit (not limited for the lower bracket spouse) may exceed the tax detriment of claiming the exemption on the lower tax rate return.

In a multiple support agreement situation, the qualifying child may meet the Code Sec. 24(c)(1)(C) relationship test for some members of the support group but not for others. The support

agreement members should consider that the child tax credit may be lost if they allocate the dependency exemption to a member who would not meet the relationship test referred to in Code Sec. 24.

Example. Sally and Paul Smith have three children and earned income of $25,000. Assuming that all amounts are the same as 1997 amounts, their tax liability would be:

Income	$25,000
Standard deduction	($ 6,900)
Personal exemptions	($13,250)
Taxable income	$4,850
Tax on $4,850	$ 727
Earned income credit	$ 904
FICA paid	$1,912.50

The Smith's child credit limitation is $1,735.50, which is the greater of:

(1) $727 regular tax liability – $0 tentative tax liability, or

(2) $1,735.50 ($727 regular tax liability + $1,912.50 FICA – $904 EIC).

They are therefore entitled to the full credit of $1,200 in 1998 or $1,500 in 1999. Because (2) is greater than (1), $473 of the credit in 1998 ($1,200 – $727) or $773 of the credit in 1999 ($1,500 – $727) is treated as a refundable credit. Thus, the Smiths have refundable credits (child credit and EIC) totaling $1,377 in 1998 ($473 + $904) or $1,677 in 1999 ($773 + $904).

Planning Note. The IRS has been instructed to attempt to simplify these calculations.

PRACTICAL ANALYSIS. Professor Karen Kole of the University of Tulsa School of Law notes that the child care credit is yet another provision ostensibly designed to benefit lower and middle class taxpayers but is so complicated and difficult to understand not only by practitioners but also by laypersons that very few deserving taxpayers will benefit from the provision. For example, to ascertain if the credit is available to a taxpayer, definitions such as qualifying child, "modified adjusted gross income" (meaning adjusted gross income increased by certain foreign income under Code Sec. 911, 932, or 933), and exceptions for certain noncitizens make the provision one that only paid tax return preparers will be able to correctly determine. The relatively small amount of the basic child care credit, $500, would end up being reduced by the amount the taxpayer will have to pay to have a preparer figure out the tax. The Supplemental Child Credit, confusing in and of itself, seems designed to benefit only those taxpayers whose Earned Income Credit exceeds the amount of FICA withholding.

Effective date. The credit applies to tax years beginning after December 31, 1997.

Act Sec. 101(a), adding Code Sec. 24; Act Sec. 101(b), adding Code Sec. 32(m); Act Sec. 101(c), amending Code Sec. 501(c)(26); Act Sec. 101(d), adding Code Sec. 6213(g)(2)(I); Act Sec. 101(e). Law at ¶ 5005, 5015, 5171, and 5623. Committee Report at ¶ 10,115 and 10,125.

Adoption Tax Credit and Exclusion

¶ 122

Background

Taxpayers are allowed a tax credit of up to $5,000 per child for qualified adoption expenses, including reasonable and necessary adoption fees, court costs, attorney fees, and other expenses directly related to the adoption of an eligible child ($6,000 in the case of a child with special needs). This provision, as promulgated in the Small Business Job Protection Act of 1996 (P.L. 104-188), did not specify that expenses incurred during the tax year in which the adoption was finalized were allowed only in that tax year. Thus, it appeared to give taxpayers the option of taking the credit during the tax year subsequent to the tax year in which the adoption was finalized.

Conforming treatment of qualified adoption expenses.—Individual taxpayers are allowed a credit for qualified adoption expenses which they pay or incur. The Taxpayer Relief Act of 1997 clarifies the tax year for which the credit for adoption expenses is allowed for the payment of qualified adoption expenses. If adoption expenses are paid during a tax year *prior* to the tax year in which the adoption is finalized, the credit is allowed during the year the adoption is finalized. If adoption expenses are paid during or after the tax year in which the adoption is finalized, the credit is allowed for the tax year in which the expense is paid or incurred. Another technical correction deletes redundant references to other Code sections used in calculating the taxpayer's adjusted gross income for this purpose.

> **Example.** David and Susan Green begin proceedings to adopt an infant in 1997. During 1997, the Greens incur expenses of $4,000. During 1998, the year in which the adoption is finalized, they incur additional expenses of $2,000. The Greens must wait until the 1998 tax year to claim the tax credit for their 1997 adoption expenses. The 1998 expenses are also claimed on their 1998 tax return because the adoption is finalized in that year. However, the total credit on their 1998 return is limited to $5,000. The $5,000 limit is a per-child limit, not an annual limitation. If the infant qualified as a special needs child, the Greens could claim the entire $6,000 of expenses as a credit on their 1998 tax return.

Effective date. This provision is effective for tax years beginning after December 31, 1996.

Act Sec. 1601(h)(2)(A) and (B), amending Code Secs. 23(a)(2) and (b)(2)(B); Act Sec. 1601(j). Law at ¶ 5003. Committee Report at ¶ 13,685.

¶ 125

Background

Prior to the Taxpayer Relief Act of 1997, the phaseout range of the exclusion for employer-provided adoption assistance programs did not conform with the phaseout range of the adoption tax credit.

Conforming language regarding adoption assistance programs.—When an adoption assistance program is provided by an employer, employees may exclude from gross income amounts received for qualified adoption expenses. Similar to the adoption tax credit, the amount excluded from the taxpayer's income

may not exceed $5,000 ($6,000 in the case of a child with special needs). The exclusion is proportionately phased out for taxpayers whose adjusted gross (AGI) income exceeds $75,000 and fully phased out for taxpayers whose AGI exceeds $115,000. The Taxpayer Relief Act of 1997 conforms the language of Code Sec. 137(b)(1) regarding the dollar limitation for adoption assistance programs with the language of Code Sec. 23(b)(1) regarding the dollar limitation for the adoption tax credit. Code Sec. 137(b)(1) now limits "the aggregate of the amounts paid or expenses incurred which may be taken into account," rather than "the amount excludable from gross income." The effect of the amendment is to conform the phaseout range of the adoption assistance exclusion to the phaseout range of the credit for qualified adoption expenses.

Effective date. This provision is effective for tax years beginning after December 31, 1996.

Act Sec. 1601(h)(2)(C), amending Code Sec. 137(b)(1); Act Sec. 1601(j). Law at ¶ 5059. Committee Report at ¶ 13,695.

Restrictions on Earned Income Credit

¶ 127

Background

Many lower-income workers are entitled to the refundable earned income credit (EIC) if they meet various income and other eligibility requirements. The amount of the credit is determined by the number of children the taxpayer supports and phases out when the taxpayer's earned income (or adjusted gross income, if greater) reaches certain levels. (In 1997, the credit is completely phased out for taxpayers with two or more children when earned income reaches $29,290.) In the past, various studies have indicated that the EIC is widely abused (relative to other Code provisions), and various preventative measures have been implemented (e.g., requiring the social security numbers of qualifying children).

For purposes of the EIC phaseouts, adjusted gross income disregards the following losses: (1) net capital loss (if greater than zero), (2) net losses from trusts and estates, (3) net losses from nonbusiness rents and royalties, and (4) 50 percent of net losses from business.

Although the generally applicable accuracy-related and fraud penalties may apply if a taxpayer improperly claims an EIC, prior to the Taxpayer Relief Act of 1997, no penalty was aimed specifically at taxpayer abuse of the EIC. Similarly, although income tax return preparers are subject to general penalties for improper return preparation, under prior law, no unique penalty applied to preparers who took improper EICs on behalf of their clients. Additionally, prior to the Taxpayer Relief Act of 1997, taxpayers who had improperly claimed the EIC were not required to prove their eligibility for the credit in subsequent years.

Changes relating to compliance and phaseout ranges.—The new law contains a number of earned income credit (EIC) "compliance provisions." These provisions deny earned income tax credit eligibility for prior acts of recklessness or fraud, require recertification for eligibility in future years when the credit is denied in a deficiency proceeding, and impose a due diligence requirement on return preparers. The Act also makes modifications to the definition of earned income and the definition of adjusted gross income (AGI) used to phase out the earned income tax credit.

Denial for recklessness or fraud. Taxpayers who negligently or fraudulently claim the EIC are prohibited from claiming future credits for a period of years. The disallowance period is two years after the most recent tax year for which there was a final determination that the taxpayer's EIC claim was due to recklessness or intentional disregard of the rules or regulations (but not due to fraud). The disallowance period increases to 10 years after the most recent tax year for which there was a final determination that the taxpayer fraudulently claimed the EIC.

Caution. The EIC disallowance sanction is imposed in addition to any other penalty (e.g., the accuracy-related penalty or the fraud penalty).

The final determination of fraud or recklessness is made in a deficiency proceeding. Although deficiency proceedings allow for judicial review, a judgment is not a prerequisite for the disallowance; an operative determination, provided it is final, may be made by the IRS. Under the deficiency procedures, a contact letter is sent to the taxpayer. If the taxpayer does not supply the requisite information, the IRS sends a statutory notice of deficiency and the taxpayer has 90 days to file a Tax Court petition. If no petition is filed and there is no other response to the statutory notice, assessment is made and the EIC is denied.

Recertification required for improper EIC claim. A taxpayer who has been denied an EIC in a deficiency procedure may not claim the EIC in any future tax year unless the taxpayer provides the IRS with evidence of eligibility for the credit. Once the IRS certifies entitlement to the EIC, the taxpayer is not required to prove eligibility again unless the IRS again denies the EIC in a deficiency procedure. The IRS will issue guidance detailing the required evidence.

Failure to provide information necessary for recertification is treated as a mathematical or clerical error under Code Sec. 6213. Therefore, a notice on this issue will not be considered a notice of deficiency, and the IRS can summarily assess additional tax under the Code Sec. 6213 procedures without issuing a deficiency notice.

Tax preparer due diligence required. An income tax return preparer must comply with the due diligence requirements for claims for refund or returns they prepare claiming the EIC. Each failure to observe the requirements regarding the amount of, or eligibility for, the EIC will result in a penalty of $100. This penalty is in addition to any other penalty imposed.

Due diligence requirements will be imposed by the IRS through regulations. Current regulations require preparers to make reasonable inquiries about taxpayer-supplied information that appears to be incorrect, inconsistent, or incomplete, and prohibit preparers from signing returns that contain a position that does not have a realistic possibility of being sustained on its merits.

Calculating modified adjusted gross income and earned income for phaseout ranges. The new law includes a taxpayer-friendly amendment that allows more income to be excluded from adjusted gross income (AGI) for purposes of the credit phaseout. Two items of nontaxable income are added to the list of excludable income and the percentage of disregarded losses is increased. Now excluded from a taxpayer's AGI for purposes of the EIC are tax-exempt interest and nontaxable distributions from pensions, annuities, and IRAs (provided these distributions are not rolled over into similar tax-favored vehicles). However, the amount of net business losses that must be disregarded is increased from 50 to 75 percent.

The way earned income is calculated also has been modified. Certain workfare payments earned by the taxpayer are not included in earned income for EIC

purposes. These payments are those received for work activities (including work associated with the refurbishing of public housing) if sufficient private sector employment is not available and from community service programs (sections 407(d)(4) and 407(d)(7) of the Social Security Act).

PRACTICAL ANALYSIS. Professor Karen Kole of the University of Tulsa School of Law observes that Congress seems to be using a sledgehammer to kill a fly regarding the problems of the Earned Income Credit and the fraud that has been associated with the administration of the credit. In fact, Congress may be trying to kill the wrong fly. It is common knowledge that the earned income credit provisions are among the most complicated and difficult provisions in the Code to apply correctly. This is particularly true since taxpayers entitled to the earned income credit tend to be taxpayers at the lower end of the education level and often taxpayers who do not have English as their first language and generally do not understand the tax system or how to fill out tax returns.

The earned income credit would be denied for 10 tax years following a tax year for which there was a final determination that the taxpayer's claim of credit was due to fraud and a denial for two tax years following a tax year for which there was a final determination that the taxpayer's claim of the credit was due to reckless or intentional disregard of rules and regulations (but not due to fraud). Presumably, the IRS would apply the reckless or intentional disregard penalty with a disclosure exception as now encompassed in Treas. Reg. § 1.6662-3(a), but even then how would the uneducated taxpayer possibly understand the subtleties of disclosure? As to fraud, the IRS merely needs to impose the penalty, and the taxpayer would have to fight the determination of fraud. Again, these taxpayers are not the ones who would be in a position, either financially, emotionally, or educationally, to fight back. It would hardly be worth the effort for the taxpayer, even if he or she could come up with the money, to hire a tax attorney, a C.P.A. or E.A. to challenge the IRS determination. On the other hand, income tax return preparers who fail to be diligent in determining the eligibility for the earned income credit will merely be slapped with a $100 penalty for each failure. This certainly seems to be a less "draconian" measure (for income tax preparers) than for the taxpayer who truly may be attempting to comply with these complex provisions and who may be potentially subject to losing thousands of dollars for a significant period of time. These thousands of dollars would presumably be taken away from paying for rent and food and other necessities. It would seem more equitable to subject the taxpayer to a $100 penalty than to totally deny the credit for a substantial period of time. Professor Kole believes that these changes with regard to the earned income credit were enacted with a goal to combat the extensive fraud that is currently inherent in the program. She doubts if these new provisions will substantially increase compliance with the complicated provisions of the earned income credit.

Effective date. The EIC compliance provisions, including those applicable to taxpayers who improperly claimed the EIC and the tax return preparer due diligence requirement, apply to tax years beginning after December 31, 1996. The changes to the calculation of the amount of a taxpayer's AGI or earned income apply to tax years beginning after December 31, 1997.

Act Sec. 1085(a)(1), redesignating Code Sec. 32(k) and (l) as (l) and (m), respectively, and adding new Code Sec. 32(k); Act Sec. 1085(a)(2) and (3), amending Code Sec. 6213(g)(2)(H) and (I) and adding Code Secs. 6213(g)(2)(J) and 6695(g); Act Sec. 1085(b), amending Code Sec. 32(c)(5)(B)(iv); Act Sec. 1085(c), adding Code Sec. 32(c)(2)(B)(v); Act Sec. 1085(d), adding Code Sec. 32(c)(5)(B)(v) and (vi); Act Sec. 1085(e). Law at ¶ 5015, 5623, and 5705. Committee Report at ¶ 11,535.

EXCLUSIONS AND FRINGE BENEFITS

Sale of Principal Residence

¶ 129

Background

Under prior law, an individual could generally defer recognition of gain on the sale of a residence if a replacement residence was purchased within two years before or after the sale of the old residence, both the old and new residences were owned and used by the individual as a principal residence, and the cost of the replacement residence was at least equal to the adjusted sales price of the old residence. Individuals age 55 or older could exclude up to $125,000 of the gain realized on the sale of their personal residence if they owned and used the residence as their principal residence for at least three years during the five-year period ending on the date of the sale.

Exclusion of gain on sale of principal residence.—Unless an individual elects otherwise, the individual may exclude from income up to $250,000 of gain realized on the sale or exchange of a residence. The individual must have owned and occupied the residence as a principal residence for an aggregate of at least two of the five years before the sale or exchange.

This exclusion replaces the rollover of gain provisions of Code Sec. 1034 and the one-time $125,000 exclusion for taxpayers age 55 or older.

Frequency of sales or exchanges limited. The exclusion applies to only one sale or exchange every two years, but pre-May 7, 1997 sales are not taken into account.

Married individuals. The amount of excludable gain is increased to $500,000 for married individuals filing jointly if (1) either spouse meets the ownership test, (2) both spouses meet the use test, and (3) neither spouse is ineligible for exclusion by virtue of a sale or exchange of a residence within the last two years.

When married individuals file a joint tax return, they will be eligible for the $250,000 exclusion, or a prorated exclusion (see "Exclusion prorated," below) if *either* spouse meets the ownership and use requirements.

Planning Note. The exclusion is determined on an individual basis. Thus, for married couples who do not share a principal residence but file joint returns, a $250,000 exclusion is available for a qualifying sale or exchange of each spouse's principal residence. Also, if a single individual eligible for the exclusion marries

someone who has used the exclusion within two years before the marriage, the individual is entitled to a $250,000 exclusion. In other words, the fact that the individual's spouse used the exclusion within the past two years does not prevent the individual from claiming the exclusion.

Planning Note. According to the legislative history of this provision, Congress wanted to make clear that the provision limiting the exclusion to only one sale every two years by the individual does not prevent a husband and wife from filing a joint tax return and each excluding up to $250,000 of gain from the sale of each spouse's principal residence. This rule applies if each spouse would have been permitted to exclude up to $250,000 of gain if they had filed separate tax returns.

Gain recognized to extent of depreciation. The exclusion does not apply, and gain is recognized, to the extent of any depreciation allowable with respect to the rental or business use of a principal residence after May 6, 1997.

Exclusion prorated. If a taxpayer does not meet the ownership or residence requirements, a pro rata amount of the $250,000 or $500,000 exclusion applies if the sale or exchange is due to a change in place of employment, health, or unforeseen circumstances. In such cases, the amount of the available exclusion is equal to the gain that would have been excluded if the ownership and residence requirements had been met, multiplied by the portion that the shorter of (1) the aggregate periods during which the ownership and use requirements were met during the five-year period ending on the date of sale or (2) the period after the date of the most recent sale or exchange to which the exclusion applied bears to two years. The extent to which the exclusion may be prorated due to a sale or exchange involving unforeseen circumstances is to be determined by IRS regulations.

> **Example.** On September 1, 1997, Al and Lisa Jackson purchase a townhouse in Boston for $450,000. Lisa receives an offer of employment in Atlanta, and on July 1, 1998, the Jacksons sell their townhouse for $480,000 and purchase a home in a suburb of Atlanta for $350,000. The Jackson's realize $30,000 of capital gain on their townhouse. Because they owned and resided in the townhouse for 10 months, they may exclude $12,500 of the gain from income ($30,000 × 10 ÷ 24 = $12,500).

Caution. The Conference Report refers to a proration of the $250,000 or $500,000 exclusion limit rather than a proration of the gain. If the conference report language were applied in the above Example, the entire gain of $30,000 would be excludable.

Certain sales within two years of enactment. A special rule provides that the exclusion may still be claimed even if the individual does not satisfy the two-year ownership and use tests and does not satisfy the requirement that the sale was due to an acceptable reason (e.g., change in the place of employment or unforeseen circumstances). However, in order to satisfy this special rule, the following two requirements must be met:

(1) the individual must have held the residence on the date of enactment (August 5, 1997), and

(2) the sale or exchange must occur during the two-year period that began on the date of enactment (August 5, 1997).

Planning Note. The $250,000 or $500,000 exclusion from income eliminates the need for many homeowners to keep records of capital improvements that increase the basis of their residences. However, records of capital improvements should be kept if there is any possibility that income might be required to be

recognized upon the sale of the principal residence. That situation might arise in the following circumstances:

(1) the individuals intend to live in the residence for a long period of time;

(2) the residence is rapidly appreciating in value;

(3) there is a possibility that the owners may claim a depreciation deduction for a home office or rental use of the residence; or

(4) there is a possibility that the owners may not use or own the residence long enough to qualify for the exclusion.

Ownership and use of prior residences. In determining the period of ownership and use of a current residence, taxpayers may include periods of ownership and use of all prior residences with respect to which gain was rolled over to the current residence under former Code Sec. 1034.

Incapacitated taxpayers. If an individual becomes physically or mentally incapable of self-care, the individual is deemed to use a residence as a principal residence during the time in which the individual owns the residence and resides in a licensed care facility (e.g., a nursing home). In order for this rule to apply, the taxpayer must have owned and used the residence as a principal residence for an aggregate period of at least one year during the five years preceding the sale or exchange.

Divorced taxpayers. If a residence is transferred to a taxpayer incident to a divorce, the time during which the taxpayer's spouse or former spouse owned the residence is added to the taxpayer's period of ownership. A taxpayer who owns a residence is deemed to use it as a principal residence while the taxpayer's spouse or former spouse is given use of the residence under the terms of a divorce or separation.

Widowed taxpayers. A taxpayer's period of ownership of a residence includes the period during which the taxpayer's deceased spouse owned the residence.

Remainder interests. The exclusion applies to gain on the sale or exchange of a remainder interest in a principal residence, provided the person acquiring the residence is not a member of the taxpayer's family or other related person as defined by Code Sec. 267(b) or 707(b).

Expatriates. The exclusion is not available to nonresident alien individuals who are subject to Code Sec. 877(a)(1) because they gave up their U.S. citizenship for the principal purpose of tax avoidance.

Involuntary conversions. For purposes of determining the exclusion, the destruction, theft, seizure, requisition, or condemnation of property is treated as a sale or exchange of the residence. In addition, the ownership and use of property acquired in an involuntary conversion generally includes the ownership and use of the property treated as sold or exchanged. For purposes of Code Sec. 1033, the amount realized from the sale or exchange of property is equal to the amount of gain, reduced by the amount of gain that is permitted to be excluded from income under this new provision.

Co-ops. In the situation of a tenant-stockholder of a cooperative housing corporation defined in Code Sec. 216, the residence ownership requirements apply to the ownership of the stock of the corporation and the use requirements apply to the house or apartment which the stockholder was entitled to occupy.

Exception to real estate transaction reporting requirements. An exception to the real estate transaction reporting requirements applies if a residence is sold for $250,000 or less ($500,000 or less if the seller is married) and the person otherwise required to report the transaction receives written assurance:

(1) that the residence is the seller's principal residence;

(2) if it would otherwise be required to report whether there is such assistance, that there is no federally subsidized mortgage financing assistance with respect to the mortgage on the residence; and

(3) that the full amount of the gain on the sale or exchange is excludable from gross income.

See, also ¶ 1050.

Planning Note. The IRS is given authority to increase these threshold reporting requirements (i.e., a sale price of more than $250,000 or $500,000) if it determines that the increase will not materially reduce income tax revenues. If the IRS does take such a step it will further reduce the reporting requirements of those that are otherwise required to report such transactions to the IRS (e.g., title companies or mortgage lenders).

PRACTICAL ANALYSIS. Sidney Kess, New York, CCH contributing editor, author and lecturer, observes that the new home sale exclusion should prove most helpful to those who downsize or move to parts of the country where homes are less expensive and who would not have qualified under the old rules (those under age 55 who would not have qualified for the old exclusion; those who did not buy replacement homes and, thus, would not have qualified for the old deferral rule).

The new exclusion was designed to eliminate the need to maintain detailed records on home improvements. However, those with considerable appreciation in the value of their homes still need good records to minimize tax on the amount of gain in excess of the exclusion.

The new home sale exclusion is not good news for everybody. Those who would have qualified under the old exclusion and/or deferral rules to avoid or postpone all tax may wind up paying some tax if gain exceeds the new exclusion amounts. Homesellers who, under a transitional rule, have the opportunity to choose between the old and new rules need to figure their tax both ways to determine which option is better for them.

Effective date. The new exclusion and repeal of the capital gains rollover provisions and one-time $125,000 exclusion apply to sales and exchanges after May 6, 1997. Taxpayers may elect to apply prior law to sales or exchanges (1) made before August 5, 1997, (2) made after August 5, 1997, pursuant to a binding contract in effect on August 5, 1997, or (3) when the replacement residence was acquired on or before August 5, 1997, and the rollover provision would apply. Such an election is not available to expatriates subject to Code Sec. 877(a)(1).

Act Sec. 312(a), amending Code Sec. 121; Act Sec. 312(b), repealing Code Sec. 1034; Act Sec. 312(c), adding new Code Sec. 6045(e)(5); and Act

Sec. 312(d), amending Code Secs. 25(e), 32(c), 56(e), 143(i) and (m), 163(h), 216(e), 280A(i), 464(f), 512(a), 1016(a), 1033(h) and (k), 1038(e), 1223(7), 1250(d) and (e), 1274(c), 6012(c), 6212(c), 6334(a), 6504, and 7872(f); and Act Sec. 312(d)[e]. Law at ¶ 5007, 5015, 5031, 5049, 5061, 5069, 5083, 5107, 5165, 5173, 5317, 5321, 5329, 5343, 5353, 5361, 5575, 5599, 5621, 5665, 5679, and 5751. Committee Report at ¶ 10,315.

Employer-Provided Parking

¶ 131

Background

Under current law, up to $170 of qualified employer-provided parking may be excluded from gross income. Qualified parking is parking provided to an employee on or near the employer's business premises, or on or near a location from which the employee commutes to work using mass transit, a commuter highway vehicle, or carpool. Prior to the Taxpayer Relief Act of 1997, however, the exclusion was only available if the parking was provided in addition to any compensation that was otherwise payable to the employee. If the employer offered the employee a choice between cash and employer-provided parking, for example, the parking exclusion was lost.

Employers permitted to offer parking or cash equivalent.—Employers who provide qualified parking for their employees are now permitted to offer the employees a choice between the parking and the cash equivalent without loss of the $170-per-month employee exclusion for employer-provided parking. The amount of cash offered is includible in an employee's income if the employee chooses the cash option. Previously, the exclusion did not apply if a cash option was offered.

Congress made this change because it believed that the old rule that prevented a cash option resulted in an overutilization of employer-provided parking as a fringe benefit. The new rule is expected to increase tax revenue and promote sound environmental and energy policy by reducing the amount of commuting by car.

Effective date. This provision is effective for tax years beginning after December 31, 1997.

Act Sec. 1072(a), amending Code Sec. 132(f)(4); Act Sec. 1072(b). Law at ¶ 5055. Committee Report at ¶ 11,455.

Foreign Earned Income Exclusion

¶ 133

Background

U.S. citizens who reside in foreign countries may be eligible for tax breaks. One such tax break is a credit for foreign taxes paid on foreign source income. Another is an exclusion for foreign-source income and housing costs. Prior to enactment of the Taxpayer Relief Act of 1997, the maximum exclusion for foreign earned income for a tax year was $70,000.

Increased dollar limitation on Code Sec. 911 exclusion.—Qualified individual U.S. citizens or residents who reside in foreign countries may be eligible to exclude from their gross income certain foreign earned income and housing costs. The Taxpayer Relief Act of 1997 phases in the increase in the limitation on the Code Sec. 911 exclusion amount as follows:

For calendar year—	*The exclusion amount is—*
1998	$72,000
1999	$74,000
2000	$76,000
2001	$78,000
2002 and thereafter	$80,000

For any tax year beginning after 2007, the $80,000 amount will be increased by multiplying the dollar amount of the limitation by the cost-of-living adjustment for the calendar year in which the tax year begins. The increase will then be rounded to the next lowest multiple of $100.

PRACTICAL ANALYSIS. Paul Bodner, Esq., Great Neck, N.Y., notes that the Code Sec. 911 exclusion, which has not kept up with inflation, is only of value to individuals working in tax havens or low tax countries. Other individuals are better off claiming the foreign tax credit. Consequently, as a practical matter, except for individuals working in tax havens, only individuals who find it easier to claim the exclusion will benefit. Often these individuals who do not have access to employer-paid professional help do not realize that in order to claim the exclusion they must file a tax return. The debate continues whether U.S. citizens living abroad for an extensive period of time should be subject to federal income tax. Many of these individuals are also citizens of a foreign country, and in some cases, may not even realize that they are also subject to U.S. taxation. Other countries only tax their residents.

Effective date. The increase in the Code Sec. 911 exclusion applies to tax years beginning after December 31, 1997.

Act Sec. 1172(a), amending Code Sec. 911(b); Act Sec. 1172(b). Law at ¶ 5291. Committee Report at ¶ 11,870.

Disability Benefits of Police and Firefighters

¶ 135

Background

Gross income does not include amounts received under a workers' compensation act. Thus, employees who receive compensation for personal injuries or sickness incurred in the course of employment or survivors of a deceased employee are not taxed on the amount received from workers' compensation. Conversely, nonoccupational death and disability benefits are not excluded from income as workers' compensation benefits. Some recipients of payments made in 1989, 1990, and 1991, on behalf of full-time employees of certain police and fire departments as compensation for heart disease or hypertension, mistakenly assumed that the exclusion for workers' compensation payments was applicable to their situations. However, because of the way their state plans were structured, these recipients were required to include the payments in income.

Disability benefits for former police and fire department employees expanded.—In general, employees who receive benefits under workers' compensation acts for injuries or sickness may exclude that compensation from gross income under Code Sec. 104(a). Former police and fire department employees who received compensation for heart disease or hypertension in 1989, 1990, or 1991 may exclude

that compensation from gross income. For individuals in those occupations, such conditions may be treated as work-related personal injuries if certain requirements are met.

Applicable payments. In order for compensation for heart disease and hypertension to be excludable from gross income, the payments received by former police and fire department employees must meet specific criteria. The individual must have been a full-time employee of a police department or a fire department organized and operated by a state, by a state agency or instrumentality, or by any political subdivision of the state, its agency or its instrumentality. State law, as of May 19, 1992, must presume that heart disease and hypertension are work-related illnesses for employees who left their employment before July 1, 1992. Finally, the payments must have been received by the former employee (or the survivors of the employee) during 1989, 1990, or 1991.

Planning Note. The wording of the Act extends the exclusion beyond police officers and firefighters to "full-time employees of a police or fire department."

Statute of limitations waiver. Claims for refunds or credits for overpayment of tax due to this provision may be filed up to one year from the date this law is enacted, regardless of applicable statutes of limitation.

Effective date. This provision is effective on August 5, 1997.

Act Sec. 1529. Law at ¶ 7070. Committee Report at ¶ 13,425.

Slain Police Officers

¶ 137

Background

A surviving spouse or surviving dependent child or children of military personnel killed in combat are entitled to survivor benefits which are exempt from taxation. Prior to the Taxpayer Relief Act of 1997, similarly situated survivors of public safety officers killed in the line of duty who received survivor annuity benefits under a governmental plan had to include these amounts in gross income unless the amounts were contributed to the plan by the deceased and were originally included in the officer's gross income.

Exemption for survivor benefits paid upon death of a police officer.— An amount paid as a survivor annuity to the spouse, former spouse or child of a public safety officer killed in the line of duty is excludable from the recipient's gross income if the annuity is provided under a governmental plan. The plan must meet the requirements of Code Sec. 401(a) for qualified plans. The annuity is excludable to the extent that it is attributable to the officer's service as a public safety officer.

For purposes of the exclusion, a public safety officer is defined in Section 1204 of the Omnibus Crime Control and Safe Streets Act of 1968. Police and law enforcement officers, fire fighters, ambulance crews, and rescue squads are all public safety officers for the purposes of that Act.

Caution. This exclusion does not apply to an officer whose death was caused by the intentional misconduct of the officer or by the officer's intent to bring about his death. The exclusion also does not apply if the officer was voluntarily intoxicated at the time of death or was performing his duties in a grossly negligent manner at the time of death.

Survivor benefits are not excludable from gross income if the recipient's actions were a substantial contributing factor to the death of the officer.

Effective date. This provision shall apply to amounts received in tax years beginning after December 31, 1996, with respect to individuals dying after that date.

Act Sec. 1528(a), adding Code Sec. 101(h); Act Sec. 1528(b). Law at ¶ 5043. Committee Report at ¶ 13,415.

EDUCATION INCENTIVES

Credits for Higher Education Tuition

¶ 139

Background

A number of tax breaks are available to help taxpayers pay for the cost of postsecondary education. However, before the Act, tax assistance was very limited for students (or their parents) who continued their education immediately after high school or who prepared themselves for a new line of work without the aid of employer-provided reimbursement. The following tax incentives are still provided for education expenses in addition to the new credit for tuition and related expenses.

(1) Taxpayers could deduct as business expenses the cost of education that maintained or improved a skill required in the taxpayer's current line of business or met express employer or legal requirements (Code Sec. 162).

(2) Employees can exclude up to $5,250 annually for education expenses paid under a qualified employer-provided educational assistance program. The exclusion was unavailable for graduate-level courses beginning after June 30, 1996 (Code Sec. 127).

(3) Taxpayers can exclude interest earned on Series EE bonds issued after 1989 provided that the bond proceeds are used to pay higher education expenses (Code Sec. 135).

(4) Degree candidates can exclude qualified scholarships used for tuition, fees and books at any primary, secondary or postsecondary educational institution (Code Sec. 117).

(5) The forgiveness of certain student loans does not generate cancellation of debt income if the forgiveness was contingent on the student working for a certain period in stipulated professions (Code Sec. 108(f)).

(6) Tax on earnings on amounts paid into qualified state tuition programs (pre-paid tuition programs) is deferred until distribution and, at distribution, is taxed to the student (presumably at their lower tax rate) (Code Sec. 529).

HOPE scholarship credit and lifetime learning credit.—New tax credits may be elected by low- and middle-income individuals for tuition expenses incurred by students pursuing college or graduate degrees or vocational training. The "HOPE scholarship credit" provides a maximum allowable credit of $1,500 per student for each of the first two years of postsecondary education, and the "lifetime learning credit" allows a credit of 20 percent of qualified tuition expenses paid by

the taxpayer for any year the HOPE credit is not claimed. Specifically, the HOPE scholarship credit initially allows taxpayers a 100-percent credit per eligible student for the first $1,000 of tuition expenses (but not room, board or books) and a 50-percent credit for the second $1,000 of tuition paid. The 20-percent lifetime learning credit is computed on the amount of tuition paid by the taxpayer and is available for the first $5,000 of tuition for tax years beginning before 2003 and for the first $10,000 thereafter.

Both credits are available for qualified tuition and related expenses incurred for the taxpayer, the taxpayer's spouse, or the taxpayer's dependent. The $1,500 maximum HOPE credit is allowed per student, while the lifetime learning credit maximum is calculated per taxpayer and does not vary based on the number of students in the taxpayer's family. The credits are elective and nonrefundable.

Caution. No double benefit is permitted; the credits are not permitted to more than one taxpayer in the same year (i.e., either parent *or* dependent child may take the credit), and cannot be claimed for the same expenses for which another tax benefit is also received.

The $1,000 amount of tuition expenses eligible for the HOPE scholarship credit and the amount used to compute the credit under the formula in Code Sec. 25A(b)(1) (discussed below) are adjusted for inflation occurring after the year 2000 (as are the income limitations discussed below). No inflation adjustment is provided for the $5,000 and $10,000 tuition amounts used to determine the amount of the lifetime learning credit.

Income limitations. The allowable amount of the credits is reduced for taxpayers who have modified adjusted gross income (AGI) above certain amounts. The phaseout of the credits begins for most taxpayers when modified AGI reaches $40,000; the credits are completely phased out when modified AGI reaches $50,000. For joint filers, the phaseout range is $80,000 to $100,000.

The amount of the credits that may be claimed for the tax year is reduced (but not below zero) by an amount that bears the same ratio to the amount which would be taken into account as the excess of the taxpayer's modified AGI over $40,000 ($80,000 for a joint return) bears to $10,000 ($20,000 for a joint return). The amount of the reduction can be determined by applying the following formula:

$$\begin{array}{c}\text{Sum of HOPE credit and}\\ \text{lifetime learning credit}\end{array} \times \frac{\text{Modified AGI} - \$40{,}000}{\$10{,}000}$$

(In the above formula, for joint returns, the $40,000 amount would be replaced with $80,000 and the $10,000 amount would be replaced with $20,000). The taxpayer's allowable credit is the amount of the credits (HOPE and lifetime learning credits) otherwise allowable to the taxpayer reduced by the reduction amount.

For purposes of the new education credits, modified AGI is AGI increased by income earned outside the United States (amounts otherwise excluded from income under Code Secs. 911, 931, and 933). Income earned in Puerto Rico and U.S. possessions is considered to be earned abroad.

The income ranges for the phaseout of the credits will be indexed for inflation occurring after the year 2000.

> **Example (1).** Carrie Smith, a single mother, has modified AGI of $46,000. In 1998, Carrie's daughter, Sonia, begins studying for her bachelor's degree as a full-time student at State University. On August 1, 1998, Carrie

pays $5,000 in qualified tuition for Sonia's first semester. Without the income limitations, Carrie would be entitled to the maximum HOPE credit of $1,500 (100% of $1,000 plus 50% of $1,000). However, taking into account the income limitations, Carrie's otherwise allowable HOPE credit of $1,500 is reduced by $900: [($46,000 − $40,000) over $10,000] × $1,500; or .6 × $1,500. Thus, Carrie is entitled to a credit of $600.

No credit for married taxpayers filing separate returns. The HOPE credit and the lifetime learning credit are not available to married taxpayers who file separate returns. The credits are available to married individuals (as defined in Code Sec. 7703) only if a joint return is filed.

HOPE scholarship credit. The HOPE scholarship credit is available only for the first two years of postsecondary education. Further, the credit can only be elected for two tax years with respect to one student (including elections by the taxpayer or any other individual). (Code Sec. 25A(b)(2)(A)).

The HOPE credit is available in the case of an eligible student (defined below) for whom the taxpayer has elected to claim the credit. The HOPE credit *maximum limit* is initially computed at $1,500. The amount of the credit is equal to the sum of (1) 100 percent of the qualified tuition and related expenses paid by the taxpayer during the tax year that does not exceed $1,000, plus (2) 50 percent of such expenses so paid as exceed $1,000 but do not exceed the "applicable limit." The "applicable limit" for any tax year is an amount equal to two times the dollar amount for the tax year (initially the dollar amount is $1,000).

The HOPE credit (and the lifetime learning credit) is available only for qualified tuition and related expenses *paid* during the tax year for education furnished to the student during an academic period *beginning* during that tax year. If tuition is paid during one tax year for an academic period that begins during the first three months of the following tax year, that academic period is treated as beginning during the year of payment (Code Sec. 25A(g)(4)).

Planning Note. The combination of this prepayment rule with the two-year limit on the HOPE credit may create tax planning opportunities. Under the two-year cap, the credit is allowed for a tax year if the student has not yet completed, before the beginning of the tax year, the first two years of postsecondary education at an eligible educational institution. For a full-time student who enters college in the autumn, that means that the credit is available for two of the first three calendar years the student attends college. In order to use the maximum credit in the earliest tax years possible, a student who enters college in the autumn and is not going to incur sufficient first-semester tuition expenses to use the full $1,500 credit for that year should be sure to pay second-semester tuition before January 1 of the following year. By paying for two semesters of instruction in the first year, these students can maximize their credit in the first calendar year they attend college (and receive only one semester of instruction).

Example (2). Barb and Ken Jones have modified AGI under $80,000. Their daughter Skipper, begins college at State University in September, 1998. Skipper, a promising writer, receives a scholarship that reduces her parents' tuition bill to $1,300 per semester. Barb and Ken make $1,300 payments as follows:

Payment Date	*Semester Begins*
July 20, 1998	September 5, 1998
January 2, 1999	January 5, 1999
August 15, 1999	September 5, 1999

December 15, 1999	January 5, 2000
August 15, 2000	September 5, 2000
December 15, 2000	January 5, 2001

If Barb and Ken elect to use their HOPE credit for 1998, they will reduce their tax liability by $1,150 (100% of the first $1,000 plus 50% of the second $1,000 they paid in 1998), and be entitled for the full credit of $1,500 for the $3,900 in tuition they pay in 1999. Thus, their two-year benefit from the HOPE credit is $350 less than it would have been had they paid Skipper's second semester tuition just two days earlier (in 1998).

Barb and Ken may be better advised to take the lifetime learning credit for 1998. If they do this, they will maximize their total tuition credit over the five calendar years Skipper is at State U.; they will be allowed credits of $4,049 ($260 + $1,500 + $1,500 + $520 + $260) versus the $3,950 ($1,150 + $1,500 + $520 + $520 + $260) they could claim if they took the HOPE credit for 1998 and 1999.

PRACTICAL ANALYSIS. David Hudson, professor in the Graduate Tax Program at the University of Florida College of Law in Gainesville, Florida, warns that even though a student is not required to take a full load to be entitled to the HOPE credit (½-time is enough), taxpayers should keep in mind that the credit is available only for two tax years and, as noted in Example (2), above, this also is relevant to full-time students since freshman and sophomore years generally span three tax years.

Hudson also warns that taxpayers should not pay for a winter or spring semester next year until January 1, 1998, since the effective date for being entitled to the credit in 1998 requires not only attendance in 1998 but also payment in 1998.

Caution. No HOPE credit is allowed for qualified tuition and related expenses for any academic period if, before the end of the tax year with or within which such academic period ends, the student is convicted of a federal or state felony consisting of the possession or distribution of a controlled substance.

Lifetime learning credit. The lifetime learning credit is allowed for 20 percent of qualified tuition and fees paid by the taxpayer with respect to one or more students, up to $5,000 of qualified tuition and fees per year for expenses paid after June 30, 1998 ($10,000 in 2003 and later years). This credit is allowed only for tax years in which the HOPE credit is not claimed with respect to the same student's tuition. Generally, the lifetime learning credit is subject to the same limitations and incorporates the same definitions as the HOPE scholarship credit (including the payment rule). However, unlike the HOPE credit:

(1) The lifetime learning credit limit does not vary with the number of students in a taxpayer's household.

(2) The lifetime learning credit is available for an unlimited number of years.

(3) The lifetime learning credit is available for both undergraduate and graduate or professional degree expenses.

(4) The lifetime learning credit may be claimed for any course at an eligible institution that helps an individual acquire or improve their job skills

(Code Sec. 25A(c)(2)(B)). (The HOPE credit requirement that students take one-half of the full-time course load for at least one academic period does not apply.) Thus, both CPE credit and noncredit professional seminars provided by eligible educational institutions may qualify for the credit.

Loans. According to the House Committee Report and the Conference Committee Report, tuition expenses paid with loan proceeds are eligible for the HOPE or lifetime learning credit in the payment year, not the year the loan is repaid.

Dependents. In order to be eligible for the HOPE credit or the lifetime learning credit, tuition must be paid for the taxpayer, the taxpayer's spouse, or the taxpayer's dependent. A student who is not the taxpayer or the taxpayer's spouse must be a dependent under Code Sec. 151 for the tax year for which the credit is claimed. If the student is claimed as a dependent by another taxpayer for a tax year beginning in the calendar year in which the student's tax year begins, the student is not allowed either credit for that year on the student's own return. If the student is claimed as a dependent by another taxpayer, any qualified tuition and related expenses paid by the student are treated as if they were paid by the other taxpayer (Code Sec. 25A(g)(3)).

PRACTICAL ANALYSIS. David Hudson, professor in the Graduate Tax Program at the University of Florida College of Law in Gainesville, Florida, notes that the education tax incentives contained in the new Act make it important for taxpayers with dependent children enrolled in college to reexamine claiming the dependency deduction. The tax credits for qualified higher education expenses may be claimed by the parent, if the child is claimed as a dependent, or by the child if the child is not claimed as a dependent by any taxpayer for the year. Because these incentives were aimed at low- and middle-income families, they are phased out after the taxpayer's modified adjusted gross income passes certain levels. In some situations, therefore, it may be preferable for a parent to forego a dependency deduction and let a child claim the deduction or credit.

Planning Note. The credits are allowed only to a parent who both pays qualified education expenses and is allowed to claim the student as a dependent. Where parents are divorced and one parent pays the tuition and the other claims the dependency exemption under a support agreement, the credit may be lost. To prevent this, support agreements should be drafted to ensure that the parent paying the tuition also claims the dependency exemption.

Qualified tuition and related expenses. Both the HOPE scholarship and the lifetime learning credits are available for tuition and fees required for enrollment or attendance at an eligible educational institution for courses of instruction. The credit is not allowed for books, lodging or meal costs, student activity fees, athletic fees, insurance expenses, transportation or other expenses unrelated to the student's academic course of instruction. Qualified tuition does not include expenses for any course or other education involving sports, games or hobbies (unless the course is part of the student's degree program).

HOPE credit: eligible student defined. In order to claim the HOPE credit (but not the lifetime learning credit) the student must be an "eligible student." An eligible student is one who is enrolled in a program leading to a degree, certificate

or other recognized educational credential at an eligible educational institution and who is carrying at least one-half of the normal full-time work load for the course of study being pursued (see below). A student who is studying abroad qualifies for the HOPE credit provided that the program is approved for credit by the institution at which the student is enrolled.

HOPE credit: student must attend at least part-time. The HOPE credit is not available if the student is considered to be attending school less than part-time. For at least one academic period which begins during the tax year, the eligible student must take at least half of the normal full-time course load for the course of study being pursued (Code Sec. 25A(b)(2)(B) and (3)(B)).

Planning Note. Part-time students may claim the HOPE credit with respect to their total tuition bill for a year in which they take one-half of a full course load for one academic period during the year, and take less than one-half of a full course load for other periods during that same year.

Double tax benefits not allowed. Generally, the credits are available for out-of-pocket expenses and no credit is allowed for any expense for which a deduction is allowed (Code Sec. 25A(g)(5)). The amount of any educational assistance paid for the benefit of the student reduces the amount of qualified tuition expense (Code Sec. 25A(g)(2)). Thus, under these rules, credits are not available for the following items that are considered to reduce the amount of qualified tuition:

(1) employer-paid educational expenses that can be excluded from an employee's income under Code Sec. 127;

(2) scholarships and fellowships received tax-free under Code Sec. 117;

(3) amounts deducted by the student as business expenses under Code Sec. 162;

(4) the amount of educational assistance excludable from the gross income of either the student or the taxpayer claiming the credit; or

(5) payments for an individual's educational expenses or attributable to the individual's enrollment at an institution that are excludable from gross income under any U.S. law.

However, the amount of tuition expenses available for the credit is not reduced for educational expenses paid by gift, bequest, devise, or inheritance (income excludable under Code Sec. 102).

Choice of credit or exclusion. For any tax year, a taxpayer is permitted to elect only one of the following with respect to one student: (1) the HOPE credit, (2) the lifetime learning credit, or (3) the exclusion for distributions from an education IRA used to pay higher education costs (Code Sec. 530; see ¶ 145). This election is separate for each student, so a parent might elect to take the HOPE credit for one child and the exclusion for distributions from an education IRA for another child. If a HOPE credit is claimed with respect to a student, then the lifetime learning credit will not be available with respect to that same student for that year (Code Sec. 25A(c)(2)(A)), although the lifetime learning credit may be available with respect to the student in other years.

If the student is not a dependent (and the parent cannot take the HOPE credit for the student), then it is the student who elects whether to take the HOPE credit or the new education IRA exclusion.

Recapture of credit. The IRS is authorized to issue regulations providing for the recapture of the HOPE credit or the lifetime learning credit where there is a refund in a subsequent tax year of any amount taken into account in determining the credit.

Eligible educational institution. Eligible educational institutions are defined in Section 481 of the Higher Education Act of 1965 (20 U.S.C. § 1088). Generally, these institutions are accredited postsecondary educational institutions that offer credit toward a bachelor's degree, an associate's degree or other recognized postsecondary credential. Some vocational institutions and proprietary institutions are eligible educational institutions. The institution must be eligible to participate in student aid programs sponsored by the Department of Education (Code Sec. 25A(f)(2)).

Nonresident aliens. If a taxpayer is a nonresident alien for any portion of the tax year, then the HOPE credit or the lifetime learning credit is available only if the individual is treated as a resident alien by reason of the election available because the person is married to a U.S. citizen or resident (Code Sec. 6013(g) or (h)).

Making the election. The IRS is authorized to prescribe regulations regarding the application and election of the HOPE credit and the lifetime learning credit elections. (The lifetime learning provisions of Code Sec. 25A(c) do not mention an election but it appears that Code Sec. 25A(e)(1) contemplates an election for both credits.) However, neither credit will be allowed unless the name and taxpayer identification number (TIN) of the student are included on the return for the year the credit is taken. Failure to provide a TIN is treated as a mathematical or clerical error on the return, and any notice issued to the taxpayer to the effect that the credit is being disallowed for failure to provide a TIN is not considered a notice of deficiency. Therefore, the taxpayer can have the IRS abate the additional tax by providing the TIN within 60 days or, if the taxpayer ignores the IRS's request for the TIN, the IRS can disregard the claimed credit (and the taxpayer must file an amended return to claim the credit), rather than following the otherwise applicable deficiency procedures (Code Sec. 6213(b)).

Information returns required. Any educational institution that receives qualified tuition and related expenses and any entity which, in the course of a trade or business, reimburses or refunds qualified tuition and related expenses (scholarship programs) must file information returns with the IRS. Entities making reimbursements or refunds include government units or agencies. If amounts are received by one person on behalf of another person, only the person first receiving the funds is required to file the information return.

Under regulations to be prescribed by the IRS, the following information must be reported:

(1) the name, address and TIN of the student with respect to whom payments were received (or paid);

(2) the name, address and TIN of the individual who will claim the student as a dependent; and

(3) the aggregate amounts of payments for qualified tuition and related expenses received with respect to the student during the calendar year, and the aggregate amount of reimbursements or refunds paid to the student during the calendar year.

Both students and persons claiming them as dependents must receive payee statements informing them of the name, address and phone number of the information contact for the person required to file the information return, and the aggregate amounts reported to the IRS. The payee statement must be furnished on or before January 31 of the year following the calendar year for which the return is made.

Penalties for failure to file information returns or payee statements will not be imposed until regulations are issued.

PRACTICAL ANALYSIS. David Hudson, professor in the Graduate Tax Program at the University of Florida College of Law in Gainesville, Florida, observes that the information reporting requirements that universities must comply with may be too much for many institutions to handle correctly during the first year of reporting. This will not only create an additional hardship for the universities, but also for the taxpayers who may be audited because of the IRS's information return document matching programs.

Coordination with exclusion of interest on educational U.S. savings bonds. The amount of qualified higher education expenses, otherwise taken into account for purposes of computing the exclusion of interest on Series EE U.S. savings bonds that are redeemed during a tax year, is reduced by the amount of such expenses that are taken into account in computing the HOPE credit or the lifetime learning credit.

Effective date. The HOPE scholarship credit and all other provisions except the lifetime learning credit apply to expenses paid after December 31, 1997 (in tax years ending after that date), for education furnished in academic periods beginning after that date. The lifetime learning credit applies to expenses paid after June 30, 1998 (in tax years ending after that date), for education furnished in academic periods beginning after that date.

Act Sec. 201(a), adding Code Sec. 25A; Act Sec. 201(b), adding Code Sec. 6213(g)(2)(J); Act Sec. 201(c), adding Code Secs. 6050S and 6724(d)(2)(Z), and redesignating Code Sec. 6724(d)(1)(B)(ix) through (xiv) as (d)(1)(B)(x) through (xv), respectively, and adding new Code Sec. 6724(d)(1)(B)(ix); Act Sec. 201(d), redesignating Code Sec. 135(d)(2) and (3) as (d)(3) and (4), and adding new Code Sec. 135(d)(2); Act Secs. 201(e) and (f). Law at ¶ 5009, 5057, 5611, 5623, and 5711. Committee Report at ¶ 10,135.

Education Investment Accounts

¶ 145

Background

A taxpayer receiving a distribution from an individual retirement account (IRA) prior to turning 59½ would generally be liable for a 10-percent penalty on the amount distributed. Although exceptions to the 10-percent penalty exist, under prior law, none applied to IRA distributions made for educational purposes.

Education individual retirement accounts.—The Act creates a new tax-favored vehicle to help low- and middle-income taxpayers save for education expenses. Joint filers with modified adjusted gross income (AGI) below $150,000 ($95,000 for singles) may contribute up to $500 per beneficiary (child) per year to an education individual retirement account (IRA). Earnings on contributions will be distributed tax free provided that they are used to pay the beneficiary's postsecondary education expenses. However, the exclusion is not available for any year in which the HOPE credit or the lifetime learning credit is claimed (see ¶ 139). Amounts remaining in an education IRA may be rolled over into another education IRA for the education of another beneficiary in the beneficiary's family or distributed to the original beneficiary who must include the earnings component of the distribution in income and pay a 10-percent penalty.

The $500 maximum annual contribution is not indexed for inflation. The income exclusion is not a tax preference item for alternative minimum tax purposes.

AGI phaseout ranges. The amount that a taxpayer is permitted to contribute to an education IRA is limited if modified AGI exceeds certain threshold amounts. The $500 annual contribution limit is phased out for joint filers with modified AGI at or greater than $150,000 and less than $160,000, and for all other filers with modified AGI at or greater than $95,000 and less than $110,000. Individuals with modified AGI at or above the $160,000 or $110,000 phaseout limits are not allowed to make contributions to an education IRA on behalf of any other individual.

Planning Note. The $500 limit applies to annual contributions to an education IRA; the phaseout applies per contributor. Thus, two higher-earning divorced parents can potentially contribute the $500 maximum to a single education IRA where, had they been married, their joint contribution would have been limited. In other words, each of two divorced parents can earn up to $95,000 ($190,000) before their contribution begins to phase out, whereas joint filers' contributions are reduced beginning at modified AGI of $150,000.

The $500 maximum annual contribution is reduced by an amount that bears the same ratio to $500 as the excess of the contributor's modified AGI for the tax year over $150,000, or $95,000, bears to $10,000 for joint filers or $15,000 for single taxpayers.

> **Example (1).** Sylvia Sawyer, a single parent, has modified AGI for the tax year of $104,000. Under the contribution phaseout provision, her annual contribution to the education IRA established for her son is limited to $200. To arrive at this amount, Sawyer must:
>
> (1) determine the excess of her modified AGI of $104,000 over $95,000 ($104,000 – $95,000 = $9,000);
>
> (2) determine the ratio that the excess amount of $9,000 bears to $15,000 ($9,000/$15,000 = .6);
>
> (3) determine the reduction amount by multiplying the maximum amount of $500 by .6 ($500 × .6 = $300); and, finally
>
> (4) subtract the reduction amount of $300 from the maximum amount of $500 to arrive at her annual contribution limit of $200 ($500 – $300 = $200).
>
> If Sawyer's ex-husband earns less than $95,000, he may contribute up to $300 to his son's education IRA for the year.

Modified AGI is the taxpayer's adjusted gross income for the tax year, increased by any amount excluded from gross income under Code Sec. 911 (relating to foreign earned income), Code Sec. 931 (relating to income sources within Guam, American Samoa, or the Northern Mariana Islands) and Code Sec. 933 (relating to income from sources within Puerto Rico).

$500 limit cannot be circumvented by multiple education IRAs. The same mechanism that discourages taxpayers from circumventing the $2,000 annual limit on regular IRAs applies to annual contributions greater than the $500 limit on education IRAs. Specifically, Code Sec. 4973 imposes a six-percent excise tax on excess contributions. An excess contribution is (1) the amount by which contributions to all education IRAs for a single beneficiary exceeds $500, plus (2) contributions during the year made to a qualified state tuition program on behalf of the beneficiary. Excess contributions do not include amounts refunded to the contributor before the contributor's return for the year is due (April 15 of the year following the tax year) or rollovers from other education IRAs.

Caution. No contribution can be made by any person to an education IRA established for a beneficiary during any tax year in which contributions are made by anyone to a Code Sec. 529 qualified state tuition program on behalf of the same beneficiary.

Distributions. Generally, contributions to education IRAs are treated as gifts. Thus, distributions from education IRAs can be made only to beneficiaries. Distributions from education IRAs are excludable from gross income to the extent that the distribution does not exceed the qualified higher education expenses incurred by the beneficiary during the year in which the distribution is made. Distributions are tax exempt regardless of whether the beneficiary attends an eligible educational institution on a full-time, half-time, or less than half-time basis. A taxpayer may elect to waive the exclusion of distributions from tax for any tax year.

Caution. Room and board expenses constitute qualified higher education expenses only if the student incurring the expenses is enrolled at an eligible institution on at least a half-time basis. (See the discussion of eligible education expenses, below.)

Distributions are deemed paid from both contributions (which are always tax free) and earnings (which may be excludable). The amount of contributions distributed is determined by multiplying the distribution by the ratio that the aggregate amount of contributions bears to the total balance of the IRA at the time the distribution is made.

> **Example (2).** Alicia Bryant receives a $1,000 distribution from her education IRA. On the date the distribution is made the account balance is $10,000, and contributions made to the account total $6,000. The amount of the distribution considered to come from contributions is $600 ($1,000 × ($6,000/$10,000 or .6)).

If aggregate distributions exceed expenses during the tax year, qualified education expenses are deemed to be paid from a pro rata share of both principal and interest. Thus, the portion of earnings excludable from income is based on the ratio that the qualified higher education expenses bear to the total amount of the distribution. The remaining portion of earnings are included in the income of the distributee.

Example (3). Alicia Bryant receives a $1,000 distribution from her education IRA. The distribution consists of $600 of contributions and $400 of earnings. Bryant pays $750 in qualified education expenses for the year. The amount of earnings excludable from Bryant's income is $300 ($400 × ($750/$1,000 or .75)). The remaining $100 is included in Bryant's income.

Additional tax on distributions not used for education. The tax imposed on any taxpayer who receives a payment or distribution from an education IRA that is includible in gross income will be increased by an additional 10 percent. The additional 10-percent tax does not apply to distributions:

(1) made to a beneficiary or the estate of a designated beneficiary after the beneficiary's death;

(2) attributable to the designated beneficiary being disabled (as defined under Code Sec. 72(m)(7));

(3) made on account of a scholarship or allowance (as defined under new Code Sec. 25A(g)(2)) received by the account holder to the extent the amount of the distribution does not exceed the amount of the scholarship or allowance; or

(4) that constitute the return of excess contributions and earnings thereon (although earnings are includible in income).

Amounts not distributed from education IRAs; rollovers. Amounts held in an education IRA may be distributed and put into an education IRA for a member of the beneficiary's family. Such distributions will not be included in the distributee's gross income provided the rollover occurs within 60 days of the distribution. Similarly, any change in the beneficiary of an education IRA does not constitute a distribution for gross income purposes if the new beneficiary is a member of the family of the original beneficiary. A person's family members are determined under Code Sec. 529(e)(2) (see ¶ 149).

Planning Note. The term "family" is defined so that amounts can be rolled over from education IRAs for the benefit of children. Therefore, if Parent sets up an education IRA for Child and Child does not use all of the accumulated funds, the education IRA could be rolled over for the benefit of Grandchild (after Grandchild is born). Rollovers do not count toward the annual $500 limit.

Amounts held in an education IRA may also be rolled over into another education IRA for the benefit of the same beneficiary (e.g., to change the investment vehicle).

Qualified higher education expenses. Tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution fall under the definition of qualified higher education expenses. The term also includes room and board to the extent of the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for federal financial aid programs. Room and board expenses will be considered qualified higher education costs only if (1) the designated beneficiary is enrolled in a degree, certificate, or other program leading to a recognized educational credential at an eligible educational institution and (2) the student carries at least one-half the normal full-time work load for the course of study pursued.

Qualified higher education expenses are reduced by the amount of any scholarships or other excludable financial aid received (Code Sec. 25A(g)(2); see

¶ 139). However, any amount used to purchase tuition credits or any amount contributed to a qualified state tuition program for the beneficiary is considered a qualified higher education expense.

Qualified education expenses do not include elementary or secondary school expenses.

Eligible educational institution. An eligible educational institution is generally an accredited, postsecondary educational institution offering credit toward a bachelor's degree, an associate's degree, a graduate-level or professional degree, or other recognized postsecondary credential. The new law also treats proprietary and postsecondary vocational institutions, as defined under 20 U.S.C. § 1088, as eligible educational institutions. To be considered eligible, any educational institution must be eligible to participate in the Department of Education student aid program.

Caution. Beneficiaries claiming a gross income exclusion with respect to an education IRA distribution may not also claim a HOPE credit or a lifetime learning credit for the same tax year.

Planning Note. Given the $500 annual contribution limit, it will be some time before education IRAs accumulate enough earnings to make the education IRA exclusion preferable to the HOPE credit or the lifetime learning credit. The higher the education expenses, the more likely that the Code Sec. 25A credits will yield greater benefit, particularly in the near future.

No contribution may be made by any person to an education IRA for a beneficiary during a year in which a contribution is made by anyone to a qualified state tuition program on behalf of the same beneficiary.

Account requirements. An education IRA is a tax-exempt trust created in the United States exclusively for purposes of paying the qualified higher education expenses of the trust's designated beneficiary. The trust must be designated as an education IRA at the time it is created or organized.

The trust instrument must provide that:

(1) no contribution may be accepted by the education IRA after the beneficiary attains age 18;

(2) except in the case of rollover contributions, annual contributions to the education IRA may not exceed $500 (eligible contribution may be less if the taxpayer's income exceeds certain thresholds);

(3) all contributions to the education IRA must be in cash;

(4) the trustee must be either a bank (as defined under Code Sec. 408(n)) or other person who demonstrates an ability to properly administer the trust;

(5) no portion of the trust's assets may be invested in life insurance contracts;

(6) the assets must not be commingled with other property, except in a common trust or investment fund; and

(7) upon the death of the designated beneficiary, any balance remaining to the credit of the beneficiary must be distributed within 30 days to the beneficiary's estate.

Planning Note. A custodial account may be treated as a trust under (4), above.

Prohibited uses of accounts. Like a regular IRA, an education IRA will lose its tax-exempt status if it engages in a prohibited transaction or is pledged as security for a loan. Prohibited transactions include loans and the use of account assets by the beneficiary or a fiduciary (see Code Sec. 4975(c)).

Transfers upon death or divorce. Death or divorce of the designated beneficiary need not cause a taxable distribution to the spouse or ex-spouse. The transfer of a beneficiary's interest in an education IRA to a spouse or ex-spouse under a divorce or separation agreement is not a taxable transfer, and, after the transfer, the interest in the account is treated as belonging to the spouse/ex-spouse.

Similarly, if a spouse acquires a beneficiary's interest in an education IRA because the spouse was the designated beneficiary of the account at the death of the original beneficiary, the education IRA is treated as if the spouse were the account beneficiary. However, if a person other than a spouse is the designated beneficiary, the education IRA terminates at death and the account balance is includible in the beneficiary's income as of the date of death (or, if the beneficiary is the estate, on the deceased's final income tax return).

Estate and gift tax treatment. Any contribution to an education IRA is treated as a completed gift of a present interest from the contributor to the beneficiary at the time of the contribution. Annual contributions are eligible for the gift tax exclusion under Code Sec. 2503(b) and are excludable for purposes of the generation-skipping transfer tax.

Distributions from an education IRA are generally not treated as taxable gifts. Further, if a beneficiary's interest is rolled over to another beneficiary or there is a change in beneficiary, no gift or generation-skipping transfer tax consequences result, provided that two beneficiaries are of the same generation. If a beneficiary's interest is rolled over to a beneficiary in a lower generation (e.g., parent to child or aunt to niece), the five-year averaging rule may be applied to exempt up to $50,000 of the transferred amount. An interest in an education IRA is not includible in the estate of any individual except with respect to amounts distributed on account of the death of the designated beneficiary.

Unrelated business income. Although education IRAs are generally exempt from tax, they are subject to the unrelated business income tax (UBIT) under Code Sec. 511.

Community property laws. The education IRA provisions apply without regard to any community property laws.

Information reporting. The IRS may require a trustee (or custodian) to report to both the IRS and the beneficiary on contributions, distributions, and other matters. A $50 penalty is imposed under Code Sec. 6693(a) for failure to file these reports.

Termination of education IRAs. Although not included in the Act, the Conference Committee Report indicates that when the beneficiary reaches age 30, any balance remaining in the education IRA must be distributed and the earnings portion of the distribution will be includible in the beneficiary's gross income. However, the Conference Committee Report provides that, prior to reaching age 30, the beneficiary may transfer or roll over the balance to another beneficiary who is a member of the original beneficiary's family.

PRACTICAL ANALYSIS. Bill Mears, Executive Vice President, Brown Brothers Harriman Trust Co., New York, N.Y., observes that although IRAs in themselves are not a great opportunity, as the contribution is limited to $500 per child (under age 18) per year, there are no limits on who can contribute. Unused portions can be rolled over to another "Ed" IRA, so families with many children should be able to use multiple "Ed" IRAs by combining them for the use of the younger children under these rollover provisions.

Effective date. The provisions governing education IRAs apply to tax years beginning after December 31, 1997.

Act Sec. 213(a), adding new Code Sec. 530; Act Sec. 213(b), adding Code Sec. 4975(c)(5), redesignating Code Sec. 4975(e)(1)(E) as (e)(1)(F), and adding new Code Sec. 4975(e)(1)(E); Act Sec. 213(c), adding Code Sec. 6693(a)(2)(D); Act Sec. 213(d), adding Code Sec. 4973(a)(4) and (e); Act Sec. 213(e), redesignating Code Sec. 26(b)(2)(E) through (P) as (b)(2)(F) through (Q) and adding new Code Sec. 26(b)(2)(E), and amending Code Sec. 135(c)(2); Act Sec. 213(f). Law at ¶ 5011, 5057, 5181, 5527, 5229, and 5703. Committee Report at ¶ 10,185.

Qualified State Tuition Programs

¶ 149

Background

Qualified state tuition programs are state established and maintained programs under which a person may (1) purchase, in cash, tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of the beneficiary's qualified higher education expenses, or (2) make cash contributions to an account established solely for meeting the qualified higher education expenses of the designated beneficiary. Distributions of earnings are included in the beneficiary's income to the extent they are used to pay for education; earnings distributed to the contributor are included in the contributor's gross income.

Under prior law, qualified higher education expenses did not include room and board. Institutions that could participate were limited to colleges, universities and certain vocational schools. Finally, contributions made to qualified state tuition programs were treated as incomplete gifts for estate tax purposes. Thus, gift tax consequences were determined when a distribution was made from an account and undistributed amounts were included in the contributor's estate if the contributor died before the entire account balance was distributed under the program.

Modification of qualified state tuition programs.—Provisions affecting qualified state tuition programs are clarified and expanded to provide increased benefits to a more broadly defined group of beneficiaries.

Room and board expenses. The definition of qualified higher education expenses is expanded to include room and board. Room and board expenses constitute qualified higher education expenses only if the student is (1) enrolled in a degree, certificate or other program leading to a recognized educational credential at an

eligible educational institution and (2) carrying at least half of the normal full-time work load for the course of study the student is pursuing.

Room and board expenses may be considered qualified higher education expenses only to the extent of the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for federal financial aid programs.

Eligible educational institution. An eligible educational institution is generally an accredited postsecondary educational institution offering credit toward a bachelor's degree, an associate's degree, a graduate-level or professional degree, or other recognized postsecondary credential. The new law also treats proprietary and postsecondary vocational institutions, as defined under 20 U.S.C. § 1088, as eligible educational institutions. To be considered eligible, any educational institution must be qualified to participate in the Department of Education student aid programs.

Family member. For purposes of account rollovers and beneficiary changes, the definition of a member of the beneficiary's family is expanded to include anyone qualifying as a dependent under Code Sec. 152(a) or the spouse of anyone qualifying as a dependent. Family members now include sons, daughters, brothers, sisters, nephews, nieces, certain in-laws, and the spouses of those relations. The requirement that a distribution be transferred to a member of the family and that a change of beneficiary be made only to a member of the family does not apply to a state tuition program contract issued prior to August 20, 1996 (enactment date of Code Sec. 529).

Interaction with HOPE and lifetime learning credits. To the extent that a distribution from a qualified state tuition program is used to pay for qualified tuition and fees, the distributee will be able to claim the HOPE credit or lifetime learning credit under new Code Sec. 25A (see ¶ 139). Similarly, the HOPE and lifetime learning credits may be taken for payments of qualified education expenses that are made in kind from a qualified state tuition program.

Coordination with education savings bonds. Taxpayers are entitled to redeem U.S. Savings Bonds and exclude the earnings under Code Sec. 135 (as if the proceeds were used to pay higher education expenses) if the redemption proceeds are contributed to a qualified tuition program on behalf of the taxpayer, the taxpayer's spouse or a dependent. In that case, the beneficiary's basis in the bond proceeds contributed on their behalf to the qualified state tuition program will be the contributor's basis in the bonds (i.e., the original purchase price).

Estate and gift tax modifications. Any contribution to a qualified state tuition program is treated as a completed gift of a present interest from the contributor to the beneficiary at the time of the contribution. Annual contributions are eligible for the gift tax exclusion under Code Sec. 2503(b) and are excludable for purposes of the generation-skipping transfer tax, provided that the annual gift tax exclusion limit ($10,000 for a single individual, $20,000 for a married couple electing gift-splitting) is not exceeded. A contributor making a contribution in excess of the exclusion limit may elect to have the contribution treated as if made ratably over five years. A gift tax return must be filed with respect to any contribution in excess of the annual gift tax exclusion limit.

> **Example (1).** Heinrich Ernst contributes $30,000 to a qualified state tuition program, the designated beneficiary of which is his daughter, Gretchen. At Heinrich's election, the program treats the $30,000 as being paid ratably over a five-year period at $6,000 per year. Heinrich may make up to

$4,000 in other gifts to Gretchen per year without exceeding the exclusion. Heinrich must make the election for the five-year averaging on his gift tax return.

If a contributor making a contribution in excess of the gift tax exclusion limit dies during the five-year period, the portion of the contribution that has not been allocated is included in the contributor's estate.

Example (2). Assume that the facts are the same as in Example (1), except that Heinrich dies after the first year. $6,000 is allocated to the first year and $6,000 is allocated to the year of death. The remaining $18,000 is included in Heinrich's gross estate.

If a beneficiary's interest is rolled over to another beneficiary or there is a change in beneficiary, no gift or generation-skipping transfer tax consequences result, provided that the two beneficiaries are of the same generation. If a beneficiary's interest is rolled over to a beneficiary in a lower generation (e.g., parent to child or aunt to niece), the five-year averaging rule may be applied to exempt up to $50,000 of the transfer.

Information reporting. Officers and employees of qualified state tuition programs are required to report contributions to and distributions from program accounts. Failure to make required reports now carries a penalty of $50 per failure.

Transitional rule. For any contract issued prior to August 20, 1996 (the date that Code Sec. 529 was enacted), the provision that allows rollovers and beneficiary changes (Code Sec. 529(c)(3)(C)) applies in tax years ending after August 20, 1996, without regard to the requirement that the distribution be transferred to a member of the family or the requirement that a change in beneficiaries may be made only to a member of the family.

Effective date. Except as otherwise provided, this provision is effective on January 1, 1998. The provision relating to room and board expenses is generally effective for tax years ending after August 20, 1996. The provision relating to the definition of eligible educational institutions is effective for distributions made after December 31, 1997, with respect to expenses paid after that date (in tax years ending after that date), for education furnished in academic periods beginning after that date. The provision coordinating Code Sec. 529 with the education savings bonds provision is effective for tax years beginning after December 31, 1997. The provision treating contributions as completed gifts and permitting five-year averaging, and the provisions preventing distributions from being treated as gifts and generation-skipping transfers apply after August 5, 1997. The provisions regarding estate tax apply to estates of decedents dying after June 8, 1997.

Act Sec. 211(a), amending Code Sec. 529(e)(3); Act Sec. 211(b), amending Code Sec. 529(b)(5), (c)(2), (c)(4), (c)(5), (e)(2) and (e)(5); Act Sec. 211(c), adding Code Sec. 135(c)(2)(C); Act Sec. 211(d), amending Code Sec. 529(c)(3)(A); Act Sec. 211(e), amending Code Sec. 529(d) and adding Code Sec. 6693(a)(2)(C); Act Sec. 211(f). Law at ¶ 5057, 5179, and 5703. Committee Report at ¶ 10,175.

¶ 154

Background

The Small Business Job Protection Act of 1996 (P.L. 104-188) provided a special transitional rule for tuition credit or certificate plans many states had established prior to the effective date of the exemption of state tuition programs from most taxes (Code Sec. 529). This special transitional rule provided that if (1) a

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state maintained on August 20, 1996, a program under which persons could purchase tuition credits on behalf of, or make contributions for education expenses of, a designated beneficiary and (2) such program met the requirements of a qualified state tuition program before the later of (a) August 20, 1997, or (b) the first day of the first calendar quarter after the close of the first regular session of the state legislature that began after August 20, 1996, then the provisions of the Small Business Act would apply to contributions (and related earnings) made before the date the program qualified as a state tuition program, without regard to whether the requirements of a qualified state tuition program are satisfied with respect to such contributions and earnings (e.g., even if the interest in the tuition or educational savings program covers not only higher education expenses but also room and board). Until the Taxpayer Relief Act of 1997, the special rule did not apply to contracts entered into for such programs.

Qualified tuition program amendment.—The rules for granting a tax exemption to a state qualified tuition program, except for the Code Sec. 511 tax on unrelated business taxable income, were enacted by the Small Business Job Protection Act of 1996, effective on August 20, 1996. The 1996 Act contained a transitional rule that grandfathered certain state tuition credit programs if such programs met the requirements of a state tuition program within specified dates. The transitional rule applied to *contributions (and earnings allocable to contributions)* made before the date that the program meets the requirements of a qualified state tuition program. After amendment by the Taxpayer Relief Act of 1997, the transitional rule applies to *contributions (and earnings allocable to contributions) made pursuant to a contract entered into under the program* before the date that the program meets the requirements of a qualified state tuition program.

Effective date. This provision generally applies to tax years ending after August 20, 1996.

Act Sec. 1601(h)(1)(c), amending Act Sec. 1806(c)(2)(B)(ii) of the Small Business Job Protection Act of 1996 (P.L. 104-188). Law at ¶ 7076. Committee Report at ¶ 13,680.

Educational Assistance Exclusion

¶ 156

Background

Prior to the Taxpayer Relief Act of 1997, educational assistance payments made by an employer under a qualified educational assistance program were excluded from an employee's income only for tax years beginning before June 1, 1997. Further, the exclusion only applied to amounts paid with respect to graduate-level courses that began before July 1, 1996, and with respect to other courses that began before July 1, 1997. The exclusion covers tuition, fees, books, supplies and equipment, but is limited to $5,250 of educational assistance per individual during a calendar year.

Employer-provided educational assistance programs.—The exclusion for employees for employer-provided educational assistance is extended. Expenses paid by an employer for courses beginning before June 1, 2000, are excludable from the employee's income. The excludable amount of tuition, fees, and related expenses is

limited to $5,250 per individual per year. Expenses paid for graduate-level courses remain ineligible for the exclusion.

Effective date. The provision is effective for tax years beginning after December 31, 1996.

Act Sec. 221(a), amending Code Sec. 127(d); Act Sec. 221(b). Law at ¶ 5051. Committee Report at ¶ 10,215.

Interest on Education Loans

¶ 157

Background

The Tax Reform Act of 1986 (P.L. 99-514) generally repealed the deduction for personal interest, such as interest on car loans and credit card debt. Thus, under prior law, interest on loans used to fund a student's college education was generally not deductible. Homeowners, however, could apply funds from a home equity loan toward education costs and often receive a deduction for the additional mortgage interest.

Deduction for interest on education loans.—Beginning in 1998, individuals will be allowed to deduct interest paid during the tax year on any qualified education loan. The maximum deductible amount of interest will rise from $1,000 in 1998 to $2,500 in 2001 and thereafter. The maximum deductible amounts of interest on education loans are set forth in the following chart.

Tax year beginning in:	*Maximum deductible amount of interest:*
1998	$ 1,000
1999	$ 1,500
2000	$ 2,000
2001 and after	$ 2,500

Caution. Although the maximum deductible amounts will increase over a four-year phase-in period, they will not be indexed for inflation.

Qualified education loan. A qualified education loan is any debt incurred to pay the qualified higher education expenses (see below) of the taxpayer, the taxpayer's spouse, or an individual who was the taxpayer's dependent at the time that the debt was incurred. The expenses must be paid or incurred within a reasonable period of time before or after the debt is incurred and must be attributable to education furnished during a period during which the recipient was an eligible student.

An eligible student is defined in new Code Sec. 25A(b)(3) (see ¶ 139) as a student who meets the requirements of section 484 of the Higher Education Act of 1965 (20 U.S.C. § 1091(a)(1)). In general, this means an individual who is enrolled or accepted for enrollment in a degree, certificate, or other program leading to a recognized credential at an eligible institution of higher education.

Caution. In order to qualify, the education expenses must be attributable to a period during which the student was attending an eligible educational institution at least half-time, meaning one-half of the normal full-time work load for the course of study that the student is pursuing.

For purposes of the deduction, a qualified education loan also encompasses debt used to refinance the qualified education loan. However, any debt owed to a

related party, as defined in Code Sec. 267(b) or 707(b)(1), is not a qualified education loan. Among the related parties listed in these sections are members of a family, a corporation and an individual who owns more than 50 percent in value of the corporation either directly or indirectly, a partnership and a person owning more than a 50-percent capital or profits interest in the partnership, a grantor and a fiduciary of a trust, a fiduciary and a beneficiary of a trust, a fiduciary of a trust and a beneficiary of another trust if the grantor of both trusts is the same, and fiduciaries of two trusts if the grantor of both trusts is the same.

> **Example (1).** In 1998, Brian Morris borrows $15,000 from his grandmother to pay for his college tuition for that year. The loan is in writing and requires Morris to pay $1,200 of interest on the loan for the year. None of the interest is deductible because the principal was borrowed from a related party.

Qualified higher education expenses. Qualified higher education expenses are the costs of attending an eligible educational institution (see below), less adjustments for certain nontaxable educational benefits. The costs of attendance are generally the costs of tuition, fees, room and board, and related expenses, such as books and supplies, as defined in section 472 of the Higher Education Act of 1965 (20 U.S.C. § 1087ll).

The adjustments are for amounts excluded from gross income with respect to:

(1) employer-provided educational assistance (Code Sec. 127);

(2) U.S. savings bond interest used to pay higher education costs (Code Sec. 135);

(3) education individual retirement accounts (new Code Sec. 530, see ¶ 145); and

(4) allowances or payments defined in new Code Sec. 25A(g)(2), such as qualified scholarships (Code Sec. 117), educational assistance allowances, and any other excludable payments for education expenses that do not constitute a gift or inheritance (see ¶ 139).

Eligible educational institution. An eligible educational institution is defined in Code Sec. 25A(f)(2) (see ¶ 139). This term includes postsecondary educational institutions and certain vocational schools defined by reference to section 481 of the Higher Education Act of 1965 (20 U.S.C. § 1088). For purposes of this interest deduction, the term also includes an institution conducting an internship or residency program leading to a degree or certificate awarded by an institution of higher education, a hospital, or a health care facility which offers postgraduate training.

Sixty-month limitation. The deduction for interest on a qualified education loan is allowed only with respect to interest paid on the loan during the first 60 months in which interest payments are required. The 60 months do not have to be consecutive. Thus, months in which the loan is in deferral do not count against the 60-month limit. The original loan and all refinancings of the loan are treated as one loan for this purpose.

Special rules. The deduction for interest on qualified education loans is an "above-the-line" deduction that is allowed whether or not the taxpayer itemizes other deductions on Schedule A of Form 1040. However, no deduction is allowed for interest on qualified education loans if the amount is allowed as a deduction under another section of the Internal Revenue Code.

Caution. If a homeowner obtains a home equity loan to fund the costs of education and deducts interest on the loan as mortgage interest, the homeowner may not also deduct the interest as qualified education loan interest.

An individual is not entitled to the deduction if he or she may be claimed as a dependent by another taxpayer for the tax year beginning in the calendar year in which the individual's tax year begins. For married taxpayers, the deduction is allowed only if the taxpayer and the taxpayer's spouse file a joint return for the tax year. Marital status is determined under Code Sec. 7703. Thus, certain individuals who are legally separated under a divorce decree or order of separate maintenance and certain individuals who are living apart are not considered married.

Phaseout of deduction. The amount of interest on a qualified education loan that may be deducted is phased out for taxpayers at moderate income levels, based on the taxpayer's modified adjusted gross income (AGI) (see below). The phaseout begins at a modified AGI level of over $40,000 (over $60,000 for joint return filers). The deduction is completely phased out at a modified AGI level of $55,000 ($75,000 for joint return filers).

In computing the deductible amount, the deduction that would otherwise be allowed is reduced by an amount that bears the same ratio to the amount that would be taken into account as the excess of the taxpayer's modified AGI for the tax year over $40,000 ($60,000 for joint filers) bears to $15,000. The deductible amount cannot be reduced below zero. The amount of the reduction can be determined by applying the following formula:

$$\begin{array}{c}\text{Deductible amount}\\ \text{(\$1,000 maximum in 1998)}\end{array} \times \frac{\text{Modified AGI} - \$40{,}000}{\$15{,}000}$$

For joint return filers, the $40,000 amount in the above formula would be replaced with $60,000.

Example (2). Sally Jackson is single and incurs $1,500 of interest on a qualified education loan in 1998. Her modified AGI for the year is $47,500. The maximum deductible amount of interest for 1998 is $1,000, which must be reduced to account for Jackson's excess modified AGI over $40,000. Thus, the amount of her deduction is equal to $1,000 − $1,000 × (($47,500 − $40,000) ÷ $15,000), or $500.

An individual's modified AGI is equal to AGI, determined after application of:

(1) the partial exclusion from income of social security and tier 1 railroad retirement benefits (Code Sec. 86);

(2) the deduction for individual retirement account (IRA) contributions (Code Sec. 219); and

(3) the limitations on passive activity losses and credits (Code Sec. 469);

but without regard to:

(a) the deduction for interest on qualified education loans (Code Sec. 221);

(b) the exclusion from income for U.S. savings bond interest used to pay higher education costs (Code Sec. 135);

(c) the exclusion from income for adoption expenses (Code Sec. 137);

(d) the exclusion for foreign earned income and housing (Code Sec. 911);

(e) the exclusion for income from sources within Guam, American Samoa, and the Northern Mariana Islands (Code Sec. 931); and

(f) the exclusion for income from sources within Puerto Rico (Code Sec. 933).

Caution. Adjusted gross income for purposes of determining the exclusions from income for social security and tier 1 railroad retirement benefits (Code Sec. 86), U.S. savings bond interest used to pay for education (Code Sec. 135), adoption expenses (Code Sec. 137), the deduction for IRA contributions (Code Sec. 219), and the passive activity loss limitations (Code Sec. 469) should not take into account the new deduction for interest on qualified education loans.

Inflation adjustments. The modified AGI limits will be adjusted for inflation for tax years beginning after the year 2002. Thus, for those years, the $40,000 amount ($60,000 for joint filers) will be increased by the product of that dollar amount and the cost-of-living adjustment (COLA) determined under Code Sec. 1(f)(3) for the calendar year in which the tax year begins. However, for this purpose, the COLA for a calendar year is the percentage by which the Consumer Price Index (CPI) for the preceding calendar year exceeds the CPI for calendar year 2001, rather than calendar year 1992. If the product of the $40,000 amount (or $60,000 amount) and the COLA is not a multiple of $5,000, it will be rounded down to the nearest lowest multiple of $5,000.

Reporting requirements. Unless otherwise provided in regulations, a return will have to be filed by any trade or business that receives $600 or more of interest for a calendar year from an individual on one or more qualified education loans. The returns will have to contain: (1) the name, address, and taxpayer identification number (TIN) of the individual with respect to whom the interest was paid; (2) the name, address, and TIN of the taxpayer who will claim the individual as a dependent; (3) the aggregate amount of interest received for the calendar year from the individual; and (4) any other information required by the IRS (see ¶ 139).

Planning Note. According to the Conference Committee Report, it is expected that the IRS will issue regulations setting forth the reporting procedures. Lenders should be prepared to separately report to borrowers the amount of deductible student loan interest, and borrowers should be prepared to certify that the loan proceeds are being used to pay for qualified expenses.

Effective date. The amendments apply to any qualified education loan incurred on, before, or after August 5, 1997, but only with respect to any loan interest payment due and paid after December 31, 1997, and the portion of the 60-month period referred to in Code Sec. 221(d) after December 31, 1997.

Act Sec. 202(a), redesignating Code Sec. 221 as Code Sec. 222 and adding new Code Sec. 221; Act Sec. 202(b), adding Code Sec. 62(a)(17); Act Sec. 202(c), amending Code Sec. 6050S(a)(2), (b)(2) and (e); Act Sec. 202(d) and (e). Law at ¶ 5037, 5089, 5090, 5091, and 5611. Committee Report at ¶ 10,145.

Cancellation of Student Loans

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Background

Under prior law, gross income included the amount of the forgiveness of student loans made under programs sponsored by tax-exempt charitable organiza-

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tions, even when the forgiveness was contingent on the student working for a specified period of time in certain professions. Also, under prior law, gross income included the amount of the forgiveness of direct student loans made through the William D. Ford Federal Direct Loan program.

Expanded exclusion for student loan cancellations.—The "forgiveness of loan" exclusion that formerly applied only to certain student loans made directly by governmental organizations or made by educational organizations under government-sponsored programs has been expanded to apply to student loans sponsored by tax-exempt charitable organizations.

An individual's gross income does not include forgiveness of loans sponsored by tax-exempt charitable organizations, such as educational organizations or private foundations if certain conditions are met. The proceeds of such loans must be used to pay costs of attendance at an educational institution or used to refinance outstanding student loans. As is the case with student loans made by governmental organizations or under government-sponsored programs, the exclusion applies only if the forgiveness of the loan is contingent on the student's working for a specified period of time in certain professions for any of a broad class of employers. However, in the case of loans sponsored by tax-exempt organizations, two additional conditions apply (1) the student or former student must work in an occupation or area with unmet needs, and (2) such work must be performed for or under the direction of a tax-exempt charitable organization or a governmental entity.

Caution. According to the House Committee Report, the individual whose student loan is forgiven must not be employed by the lender organization in order for the exclusion to apply. The Taxpayer Relief Act of 1997 provides a more specific proscription; it indicates that the exclusion will not apply to the discharge of a student loan if the discharge is *on account of* services provided to such lending organization, which implies a more direct causal connection between the individual's provision of services and the discharge of the student loan. Although an individual is allowed to fulfill his public service requirement (work in an area with unmet needs) by working for or under the direction of a tax-exempt charity, which presumably could include the lending organization, it would behoove the individual to perform the public service work for or under the direction of another charitable organization or governmental entity so as not to jeopardize the exclusion.

Effective date. These exclusions apply to discharges of indebtedness made after August 5, 1997.

Act. Sec. 225(a)(1), amending Code Sec. 108(f)(2); Act. Sec. 225(a)(2) adding Code Sec. 108(f)(3); Act Sec. 225(b). Law at ¶ 5045. Committee Report at ¶ 10,235.

Academy Bond Credit

¶ 161

Background

Under Code Sec. 103(a), interest on bonds issued by state and local governments and political subdivisions of state governments generally is not includible in income. Regulations under Code Sec. 103 provide that school districts and other educational agencies that exercise part of a state's sovereign power are considered a political subdivision of the state. Thus, bonds issued for the support of public

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schools by properly authorized educational agencies are considered tax-exempt bonds.

Tax credit for holders of qualified zone academy bonds.— As part of the educational incentives provided in the Taxpayer Relief Act of 1997 and as an additional incentive for empowerment zones, an eligible taxpayer who is holding a qualified zone academy bond on the credit allowance date is entitled to a nonrefundable tax credit for each year in which the bond is held. Although the credit may be claimed against both regular income tax and the alternative minimum tax (AMT), the amount of the credit allowed must be included in the taxpayer's income.

Eligible taxpayers. Taxpayers that may claim the credit are certain financial institutions, including banks, insurance companies and corporations actively engaged in the business of lending money. The credit allowance date for an issue is the last day of the one-year period beginning on the date of issuance and the last day of each successive one-year period thereafter.

Amount of credit. The amount of the available credit is calculated by multiplying the credit rate determined on a monthly basis by the Treasury Department by the face amount of the bond held by the taxpayer. However, the credit is a nonrefundable credit. Therefore, the amount actually allowed to the taxpayer cannot exceed the sum of the taxpayer's regular tax liability and AMT liability, as reduced by the total amount of nonrefundable credits claimed by the taxpayer.

The credit rate is the percentage that the Treasury estimates will permit qualified academy zone bonds to be issued without discount and without interest cost to the issuer of the bonds.

Qualified zone academy bond, defined. A qualified zone academy bond is a bond, or other obligation, issued by a state (including the District of Columbia and U.S. possessions) or local government that meets the following requirements. Ninety-five percent or more of the proceeds of the bond issuance must be used for a qualified purpose with respect to a qualified zone academy that is located within the jurisdiction of the issuing governmental body. In addition, the issuer must designate the bond as a qualified zone academy bond; must certify that it has written assurance that the private business contribution will be met; and must certify that it has the written approval of the eligible local education agency for the bond issuance. Finally, the term of the bond cannot exceed the maximum term established by the Treasury Department for bonds issued during that calendar month.

Qualified zone academy. A qualified zone academy is a public school, or academic program within a public school, that has been established and operated by a local education agency (as defined in section 14101 of the Elementary and Secondary Education Act of 1965) and whose comprehensive educational plan has been approved by that agency. The school must provide education and training below the postsecondary level and must either be located within an empowerment zone or enterprise community or there must be a reasonable expectation that at least 35 percent of the students will be eligible for free or reduced-cost lunches under the National School Lunch Act. In addition, the school or program must be designed cooperatively with the business community to enhance the academic curriculum and increase graduation and employment rates, as well as better

prepare students for college and the work force. Finally, the students in the school or program must be subject to the same academic standards as other students educated by the local educational agency.

Qualified purpose. Ninety-five percent or more of bond issue proceeds must be used for one of four qualified purposes in order for the bond to be a qualified zone academy bond. Rehabilitating or repairing the facility that houses the academy constitutes a qualified purpose. Providing equipment for use at the academy or developing course material for the academy are also qualified purposes. Finally, training teachers and other school personnel in the academy is a qualified purpose.

Private business contribution requirement. To meet the private business requirement, the local educational agency establishing the qualified zone academy must have written commitments from private entities that they will make qualified contributions that have a present value (as of the date of issuance) of not less than 10 percent of the proceeds of the bond issue. The qualified contribution is a contribution of equipment (including state-of-the-art technology and vocational equipment); technical assistance in curriculum development or teacher training; services of employees as volunteer mentors; internships, field trips or other educational opportunities outside of the academy; or any other property or services specified by the local educational agency. In addition, the type and quantity of the contribution must be acceptable to the local educational agency.

Limitations on bond issue. Bond issues are subject to both maximum term limitations and maximum amount limitations. Each calendar month, the Treasury Department will establish the maximum term permitted for bonds issued during the following calendar month. The maximum term will be set so that the present value of the obligation to repay the bond is 50 percent of the face value of the bond. The present value will be determined using, as the discount rate, the average annual interest rate of tax-exempt obligations with a term of 10 or more years that are issued during the month. Where this calculation does not result in a multiple of a whole year, the term will be rounded to the next highest year.

In addition to the term limitation, there is a national dollar limitation on the amount of bonds that can be designated as qualified zone academy bonds. The amount of bonds that can be issued nationwide is $400 million for 1998, $400 million for 1999, and zero for years after 1999. The national amount will be allocated to the states based upon their respective populations of individuals below the poverty line. The amount allocated to the state is then to be allocated by the state's educational agency to qualified zone academies within the state. The maximum aggregate face amount of bonds issued during a year with respect to an academy cannot exceed the amount allocated to that academy. A state is permitted to carry over unused amounts that were allocated to it in 1998 and 1999, and issue bonds based upon that carryover.

Effective date. This provision is effective for bonds issued after December 31, 1997.

Act Sec. 226(a), redesignating Code Sec. 1397E[D] as Code Sec. 1397F and adding new Code Sec. 1397E; Act Sec. 226(b) and (c). Law at ¶ 5391-5393. Committee Report at ¶ 10,240.

INDIVIDUAL RETIREMENT ACCOUNTS

Roth IRAs

¶ 166

Background

Distributions attributable to contributions to pre-Act nondeductible IRAs are excluded from gross income when withdrawn, but earnings on such nondeductible IRA contributions are subject to ordinary income taxation and to the 10-percent income tax on early withdrawals, unless one of the exceptions applies. Prior to the Act, "Roth IRAs," which enable an individual to take tax-free distributions of the earnings on the nondeductible contributions, did not exist. In addition, prior to the Act, no one over age 70½ could contribute to an IRA or set up a new IRA to receive contributions.

Roth IRAs.—For post-1997 tax years, the Act establishes a new type of tax-favored IRA vehicle. Under this new vehicle, called a "Roth IRA," contributions will be nondeductible. Instead, the tax advantages will be "backloaded." The buildup (e.g., interest and dividends) within the account may be tax free depending on how and when the taxpayer withdraws money from the account. To be treated as a Roth IRA, the account must be designated as such when it is established. A Roth IRA is treated like an ordinary IRA except for the special rules described below.

Contribution limits. The contribution limits on deductible and nondeductible IRAs are coordinated. Also, pre-Act nondeductible IRAs are retained. Thus, an individual who cannot or does not make contributions to a deductible IRA or a Roth IRA can still make contributions to a pre-Act nondeductible IRA. However, the maximum total yearly contribution that can be made by an individual to all IRAs (deductible, pre-Act nondeductible, and Roth) is $2,000, not counting rollover contributions (see below). Unlike deductible IRAs, individuals are allowed to make contributions to a Roth IRA even after age 70½.

Excess contributions to a Roth IRA are subject to the six-percent tax under Code Sec. 4973.

PRACTICAL ANALYSIS. Bill Mears, Executive Vice President, Brown Brothers Harriman Trust Co., New York, N.Y., observes that in evaluating whether to use a deductible IRA or a "Roth" IRA, it is necessary to consider the impact on taxation of social security benefits. Deductible IRA proceeds are part of adjusted gross income and, therefore, will possibly increase tax on social security benefits. Roth IRA proceeds will not have this effect.

Income limits. Roth IRAs are subject to income limits. The maximum yearly contribution that can be made to a Roth IRA is phased out for single taxpayers with adjusted gross income (AGI) between $95,000 and $110,000 and for joint filers with AGI between $150,000 and $160,000.

Example (1). Mary Heaney, a single taxpayer with AGI of $120,000, is ineligible to contribute to a Roth IRA because her income exceeds the legal threshold. However, she may contribute to a pre-Act nondeductible IRA.

If the final result is below $200 but above zero, the deduction limit will be $200. Also, any result which is not a multiple of $10 must be rounded to the next lowest $10.

Taxation of distributions. Qualified distributions from a Roth IRA are not included in the taxpayer's gross income and are not subject to the additional 10-percent early withdrawal tax. To be a qualified distribution, the distribution must satisfy a five-year holding period and must meet one of four requirements (see below).

To satisfy the five-year holding period, the Roth IRA distribution (including distributions allocable to rollover contributions (see below)) may not be made before the end of the five-tax-year period beginning with the first tax year for which the individual (or the individual's spouse) made a contribution to the Roth IRA.

Caution. As is the case with deductible IRAs, a contribution to a Roth IRA for a tax year can be made by the due date for filing the individual's tax return for the year (without regard to extensions). In such a case, the Senate Finance Committee Report notes, the five-year holding period begins to run with the tax year to which the contribution relates, not the year in which the contribution is actually made.

> **Example (2).** Lisa Hanes makes a contribution to her Roth IRA in February 1999, designating the contribution for 1998. Hanes' holding period thus begins running in 1998, not in 1999 when the contribution was actually made.

In addition to satisfying the five-year holding period, a qualified distribution must be:

(1) made on or after the date on which individual attains age 59½;

(2) made to a beneficiary (or the individual's estate) on or after the individual's death;

(3) attributable to the individual being disabled; or

(4) a distribution to pay for "qualified first-time homebuyer expenses" (see ¶ 177).

> **Example (3).** Maurice Moore establishes a Roth IRA at age 40 and contributes $2,000 per year to the account for 20 years. The account is now worth $100,000, consisting of $40,000 in contributions plus $60,000 in accumulated earnings. Moore may withdraw the funds in his Roth IRA tax-free because he has held the funds for the requisite five years and is over age 59½. (This example assumes that Moore met the income limits for contributing to the account.)

PRACTICAL ANALYSIS. Steve Krass of Krass & Lund, P.C., New York, New York, observes that one requirement for a qualified distribution is that it not be made within the five-taxable-year period beginning with the first taxable year for which the individual made a contribution to the Roth IRA.

For example, in 1998, John establishes a Roth IRA and contributes $1,000. John contributes $2,000 in each of 1999 and 2000 and dies in 2001, with his daughter Jane as beneficiary. On December 31, 2001,

the IRA is worth $7,500. If Jane withdraws the $7,500 in January, 2002, the $2,500 gain will be taxable to her. However, if Jane withdraws $5,000 in January, 2002 and the balance in January, 2003, both distributions will be income tax free.

The Act provides an ordering rule for purposes of determining what portion of a nonqualified distribution is includible in income. Under this rule, distributions are treated as made from contributions first. Thus, no portion of a distribution is treated as attributable to earnings, or includible in gross income, until the total of all distributions from the Roth IRA exceeds the amount of contributions. Roth IRAs and ordinary IRAs are treated separately under the taxation of distribution rules of Code Sec. 72. An excess contribution which is distributed from a Roth IRA during the tax year is treated as an amount not contributed.

Pre-death distribution rules and incidental death benefit rules do not apply. The pre-death required beginning distribution rules of Code Sec. 401(a)(9)(A) that apply to qualified plans and ordinary IRAs do not apply to Roth IRAs. Thus, the holders of a Roth IRA need not take a distribution by April 1 of the calendar year in which they attain age 70½. Also, the incidental death benefit rules of Code Sec. 401(a)(9)(G) do not apply to Roth IRAs.

Rollovers and conversions. Distributions from one Roth IRA can be rolled over or "converted" tax free to another Roth IRA. Amounts in an ordinary IRA can be rolled over into an Roth IRA, but only if:

(1) the taxpayer's adjusted gross income (AGI) for the tax year does not exceed $100,000 and

(2) the taxpayer is not married filing separately.

In this case, the 10-percent early withdrawal tax does not apply.

The Conference Committee Report makes it clear that AGI is determined before any amount is included in income as a result of the rollover or conversion.

The rollover contribution must meet the general IRA rollover rules of Code Sec. 408(d)(3), such as the 60-day limit. However, rollovers from ordinary IRAs to Roth IRAs are disregarded for purposes of the rule in Code Sec. 408(d)(3)(B) which generally limits IRA rollovers to once a year.

In the case of a rollover from an ordinary IRA to a Roth IRA, the five-tax-year holding period for escaping inclusion in income discussed above begins with the tax year in which the rollover contribution was made.

If a rollover from an ordinary IRA to a Roth IRA is made before January 1, 1999, the amount that would have been included in gross income if the individual had taken a distribution is included in gross income "ratably" over a four-tax-year period beginning with the tax year in which the payment or distribution is made. The Act directs the trustees of Roth IRAs, or trustees of ordinary IRAs, whichever is appropriate, to include in the annual reports required under Code Sec. 408(i) any additional information (as the Treasury Secretary may require) in order to ensure that rollover amounts are included in gross income.

Planning Note. The tax rules described above also apply to a "conversion" of an ordinary IRA into a Roth IRA. The Senate Finance Committee Report notes that an individual may make a conversion without actually taking a distribution. For instance, an individual may make a conversion by simply notifying the IRA trustee. Or, a conversion may be made via a trustee-to-trustee transfer. Note,

however, that if a part of an IRA balance is converted into a Roth IRA, the Roth IRA amounts may have to be held separately.

PRACTICAL ANALYSIS. Steve Krass of Krass & Lund, P.C., New York, New York, notes that, if an IRA is rolled over or converted into a Roth IRA during 1998, the amount otherwise includible in gross income due to the IRA distribution or conversion will be includible in gross income ratably over the four-taxable-year period beginning with 1998.

For example, in 1998, John rolls over a $40,000 IRA distribution to a Roth IRA. The amount of $10,000 will be includible in John's gross income in each year of 1998, 1999, 2000, and 2001. The Act contains no provision concerning John's death prior to 2001. Assuming John dies in 1999, is the remaining $30,000 includible in gross income that year; is the legal representative of John's estate required to file income tax returns on John's behalf for 2000 and 2001; does John's estate include the untaxed amounts on its 2000 and 2001 income tax returns; if John was married, must his surviving spouse include the untaxed amounts on her 2000 and 2001 income tax returns?

PRACTICAL ANALYSIS. Bill Mears, Executive Vice President, Brown Brothers Harriman Trust Co., New York, N.Y., warns that rollover from a deductible IRA to a Roth IRA is probably not an attractive strategy to most clients currently in high tax brackets. To make sense, the loss of the use of the money which is spent on taxes must be exceeded by the tax savings on the distributions. If taxes are paid initially at a high rate, even though the law allows a spread-out over four years, this becomes more difficult to achieve. Computations in making a rollover decision must be predicated on both tax rates and intended withdrawals. The penalty on withdrawal applies if adjusted gross income is greater that $100,000. This, added to the income taxes, makes rollover a very questionable strategy. State income tax laws may add extra tax burdens that make this prohibitive.

Conversion of excess contributions. If a taxpayer transfers amounts contributed to an ordinary IRA (and any earnings allocated to such amounts) to a Roth IRA by the due date for filing the return (not including extensions), the amounts are not included in the taxpayer's gross income to the extent that no deduction was allowed for the contribution.

Spousal IRA rules. The Act provides that, for purposes of the limitation on the spousal IRA deduction under Code Sec. 219(c)(1)(B)(ii), the compensation includible in the gross income of the spouse is reduced by the amount of any contribution made on behalf of the spouse to a Roth IRA.

Effective date. The provisions are effective for tax years beginning after December 31, 1997.

Act Sec. 302(a), adding new Code Sec. 408A; Act Sec. 302(b), adding new Code Sec. 4973(f); Act Sec. 302(c), amending Code Sec.

219(c)(1)(B)(ii); Act Sec. 302(d), amending Code Sec. 408(i); Act Sec. 302(e) and (f). Law at ¶ 5085, 5139, 5141, and 5527. Committee Report at ¶ 10,260.

Increased AGI Limits

¶ 172

Background

Prior to the 1997 Act, if an individual (or an individual's spouse) was an active participant in an employer-sponsored retirement plan, the maximum IRA deduction of $2,000 was phased out in the following way: for married taxpayers filing jointly, the limit was phased out between $40,000 and $50,000 of AGI; for single taxpayers, the limit was phased out between $25,000 and $35,000 of AGI.

Increase in AGI limits for making deductible IRA contributions.—The Act gradually increases the adjusted gross income (AGI) phaseout limits for deductible IRA contributions by individuals who are active participants in employer-sponsored retirement plans.

Active participants below a "threshold level" of income may make deductible IRA contributions. The maximum $2,000 deduction available to active participants is reduced proportionately over a "phaseout" range. Active participants with incomes above the phaseout range are not entitled to any IRA deduction.

The phaseout limits are increased as follows:

Tax years beginning in:	*Single taxpayers*
1998	$30,000–$40,000
1999	$31,000–$41,000
2000	$32,000–$42,000
2001	$33,000–$43,000
2002	$34,000–$44,000
2003	$40,000–$50,000
2004	$45,000–$55,000
2005 and thereafter	$50,000–$60,000

Tax years beginning in:	*Married taxpayers filing jointly*
1998	$50,000–$60,000
1999	$51,000–$61,000
2000	$52,000–$62,000
2001	$53,000–$63,000
2002	$54,000–$64,000
2003	$60,000–$70,000
2004	$65,000–$75,000
2005	$70,000–$80,000
2006	$75,000–$85,000
2007 and thereafter	$80,000–$100,000

Planning Note. Starting in 2007, the phaseout range widens to $20,000 (from $80,000 to $100,000) for married couples filing jointly.

> **Example.** Joe Augusto is a single taxpayer with AGI of $30,000 and is covered under his employer's 401(k) plan. In 1998, he makes a $2,000 IRA contribution. He is entitled to take a full deduction for this contribution. Under prior law, his deduction would have been limited to $1,000, because his AGI would have been subject to a 50-percent phaseout.

Caution. There is a separate phaseout limit that applies to individuals who are not active participants but whose spouses are active participants. See ¶ 173.

Effective date. This provision is effective for tax years beginning after December 31, 1997.

Act Sec. 301(a), amending Code Sec. 219(g)(2)(A)(ii) and (3)(B); Act Sec. 301(c). Law at ¶ 5085. Committee Report at ¶ 10,255.

Active Participation Rules

¶ 173

Background

Under prior law, if an individual was an active participant in an employer-sponsored retirement plan, his or her spouse was treated as an active participant. Thus, under prior law, the spouse was subject to the phaseout rules for deductible IRAs (see ¶ 172).

Active participant status not attributed to spouses.—An individual will not be considered an active participant in an employer-sponsored plan merely because the individual's spouse is an active participant for any part of a plan year.

Planning Note. This change in the law allows most homemakers to take a full $2,000 deduction for a contribution to an IRA, regardless of whether their spouse is covered under a retirement plan at work.

Income phaseout limits. The maximum deductible IRA contribution for an individual who is not an active participant, but whose spouse is, will now be phased out at adjusted gross incomes between $150,000 and $160,000.

> **Example (1).** Ralph is covered by a 401(k) plan at work. His wife, Alice, is a full-time homemaker. In 1998, they file jointly and have an AGI of $200,000. Neither Ralph nor Alice is entitled to make deductible contributions to an IRA for the year because they exceed the income threshold.

> **Example (2).** Assume the same facts as Example (1), except that the combined AGI of Ralph and Alice is $125,000. Alice can make a deductible contribution to the IRA for the year because she is not an active participant, and their combined AGI is below the $150,000 threshold. But Ralph cannot make a deductible contribution because he exceeds the income threshold for active participants (see ¶ 172).

PRACTICAL ANALYSIS. Steve Krass of Krass & Lund, P.C., New York, New York, points out that the deductible IRA contribution that may be made by each spouse is dependent upon the spouse's adjusted gross income (AGI). Assuming the spouses file a joint income tax return for 1998, it is unclear as to how the AGI of each spouse will be calculated. For example, if the married individuals earn interest on a jointly held bank account, what portion of the interest should be allocated to each spouse? If the married individuals deduct real estate taxes with respect to a home owned by one spouse, will that spouse receive the entire deduction?

Effective date. This provision is effective for tax years beginning after December 31, 1997.

Act Sec. 301(b), amending Code Sec. 219(g)(1) and adding Code Sec. 219(g)(7); Act Sec. 301(c). Law at ¶ 5085. Committee Report at ¶ 10,255.

Education Expense Withdrawals

¶ 174

Background

Amounts held in an individual retirement account (IRA) are includible in income when withdrawn, except to the extent that the withdrawal represents a return of nondeductible contributions. Amounts distributed from an IRA prior to age 59½ are subject to an additional 10-percent early withdrawal tax, unless the distribution is:

(1) due to death or disability;

(2) made in the form of certain periodic payments for the life or life expectancy of the individual or the individual's beneficiary;

(3) used to pay medical expenses in excess of 7.5% of adjusted gross income; or

(4) used to purchase health insurance of an unemployed individual.

Prior to the 1997 Act, amounts could not be withdrawn penalty-free for the purpose of paying education expenses.

Early withdrawal tax does not apply to IRA distributions to pay for qualified higher education expenses.—The 10-percent tax on early (pre-age 59½) withdrawals from an IRA will not apply to distributions from an IRA if the taxpayer uses the amounts to pay "qualified higher education expenses" of the taxpayer, the taxpayer's spouse, or any child or grandchild of the taxpayer or the taxpayer's spouse.

Qualified higher education expenses include tuition, fees, books, supplies, and equipment required for the enrollment or attendance at a postsecondary educational institution. The Committee Report makes it clear that qualified higher education expenses include those related to graduate-level courses.

The amount of qualified higher education expenses is reduced by the amounts of any qualified scholarship, educational assistance allowance, or payment (other than a gift, bequest, devise, or inheritance) for an individual's educational enrollment that are excludable from gross income.

Effective date. This provision is effective for distributions made after December 31, 1997, with respect to expenses paid for education furnished in academic periods beginning after that date and in tax years ending after that date.

Act Sec. 203(a), adding Code Sec. 72(t)(2)(E); Act Sec. 203(b), adding Code Sec. 72(t)(7); Act Sec. 203(c). Law at ¶ 5041. Committee Report at ¶ 10,150.

Home Purchase Distributions

¶ 177

Background

Amounts held in an individual retirement account (IRA) are includible in income when withdrawn, except to the extent that the withdrawal represents a return of nondeductible contributions. Amounts distributed from an IRA prior to age 59½ are subject to an additional 10-percent early withdrawal tax, unless the distribution is:

(1) due to death or disability;

(2) made in the form of certain periodic payments for the life or life expectancy of the individual or the individual's beneficiary;

(3) used to pay medical expenses in excess of 7.5 percent of adjusted gross income; or

(4) used to purchase health insurance of an unemployed individual.

Prior to the 1997 Act, amounts could not be withdrawn penalty-free for the purpose of making first-time home purchases.

Early withdrawal tax does not apply to IRA distributions for "first-time homebuyer expenses."—Under the Act, the 10-percent tax on early (pre-age 59½) distributions from an IRA will not apply to IRA distributions used to pay expenses incurred by qualified first-time homebuyers (up to the first $10,000).

Qualified first-time homebuyer distributions. The early withdrawal tax does not apply to "qualified first-time homebuyer distributions." Qualified first-time homebuyer distributions are withdrawals from an IRA of up to $10,000 during the individual's lifetime that are used within 120 days of withdrawal to buy, build, or rebuild a "first" home that is the principal residence of the individual, his or her spouse, or any child, grandchild, or ancestor of the individual or spouse. Acquisition costs include any usual or reasonable settlement, financing, or other closing costs.

Definition of first-time homebuyer. In order to be considered a first-time homebuyer, the individual (and spouse, if married) must not have had an ownership interest in a principal residence during a two-year period ending on the date that the new home is acquired.

> **Example.** In 1995, Joe and Mary sold the home in which they both lived and moved into an apartment. In 1998, Joe and Mary take a $10,000 distribution from their IRA to use as a down payment on the purchase of a new home. Because they have not had an ownership interest in a principal residence during the preceding two years, Joe and Mary will not have to pay an additional 10% tax on their IRA withdrawal. The amount is still subject to inclusion in their gross income, however, under the usual IRA rules.

"Acquisition" of first home. Under the law, a first home is considered to be "acquired" on the date on which a binding contract is entered into or the date of which the construction or reconstruction is begun. If there is a delay or cancellation of the purchase or construction of the first home, the amount of the distribution may be contributed back into an IRA within 120 days of receipt.

Effective date. The provisions apply to payments and distributions in tax years beginning after December 31, 1997.

Act Sec. 303(a), adding Code Sec. 72(t)(2)(F); Act Sec. 303(b), adding Code Sec. 72(t)(8); Act Sec. 303(c). Law at ¶ 5041. Committee Report at ¶ 10,265.

Investments in Bullion

¶ 180

Background

IRAs may not invest in collectibles. A collectible includes any piece of art, rug, antique, metal or gem, stamp or coin, alcoholic beverage, or other personal property as specified by the Treasury Department. Collectibles do not include coins issued by a state or certain specified gold and silver coins. Prior to the Act, however, platinum coins and gold, silver, platinum, or palladium bullion were not covered under any exception to the rule precluding IRAs from investing in collectibles.

IRAs may invest in bullion.—The Act permits IRA assets to be invested in certain platinum coins and in any gold, silver, platinum, or palladium bullion of a fineness equal to or exceeding the minimum fineness required for metals which may be delivered in satisfaction of a regulated futures contract subject to regulation by the Commodity Futures Trading Commission.

Caution. This provision does not apply unless the bullion is in the physical possession of the IRA trustee.

Effective date. The provision applies to tax years beginning after December 31, 1997.

Act Sec. 304(a), amending Code Sec. 408(m)(3); Act Sec. 304(b). Law at ¶ 5139. Committee Report at ¶ 10,270.

Partnership Items and Filing Requirements

¶ 183

Background

An individual retirement account (IRA) is generally exempt from taxation except for the taxes imposed on any income from an unrelated trade or business. The fiduciary of an IRA is required to file a return on behalf of the IRA only if the IRA has gross income of $1,000 or more that is included in the computation of unrelated business taxable income for the year (Reg. § 1.6012-3(a)(5)). In calculating unrelated business taxable income, an IRA is generally permitted a deduction for expenses directly connected to the carrying on of the unrelated trade or business, as well as a specific deduction of $1,000, under Code Sec. 512(b)(12). Consequently, an IRA with no taxable income, after taking into account the various deductions, can be required to file a return.

Before the Taxpayer Relief Act of 1997, the filing threshold rules that applied to an IRA with an interest in a partnership subject to the TEFRA level audit rules did not take into account that the appropriateness of the deductions could be determined at the partnership level.

Filing threshold modified for IRA with certain partnership interest.—Under the Act, the filing threshold for an IRA with unrelated business taxable income is modified in the case of an IRA with an interest in a partnership subject to the TEFRA partnership-level audit rules. For purposes of determining whether the IRA has met the filing threshold ($1,000 or more of gross income included in computing unrelated business taxable income), the fiduciary of the IRA can treat the IRA's share of the partnership's taxable income as gross income. The fiduciary is not required to file an income tax return if the IRA receives taxable income of less than $1,000 (before the $1,000 specific deduction) from the partnership, and the IRA does not have any other income from an unrelated trade or business.

Effective date. The filing threshold applies to partnership tax years ending on or after December 31, 1997.

Act Sec. 1225, adding Code Sec. 6012(b)(6); Act Sec. 1226. Law at ¶ 5575. Committee Report at ¶ 12,295.

Payroll Deductions

¶ 184

Background

An employer that facilitates the establishment or maintenance of IRAs for its employees may be treated as having established a retirement plan that would subject the employer to ERISA's fiduciary rules.

Contributions to IRAs through payroll deductions.—According to the Conference Committee Report, the Secretary of the Treasury is encouraged to continue his efforts to publicize the availability of payroll deduction IRAs. In addition, the Conference Committee Report states that employers that make the decision not to sponsor retirement plans should be encouraged to set up payroll deduction systems for contributions to IRAs to help employees save for retirement.

Caution. The law text does not actually include this provision. It only appears in the Conference Committee Report.

According to the Senate Finance Committee Report, employers have been reluctant to assist their employees with IRAs because such involvement may result in the employers being treated as having maintained ERISA retirement plans. One of the consequences of such treatment is that the employers are subject to ERISA's fiduciary rules. The Senate amendment originally provided for the establishment of a detailed payroll deduction system under which employers would not be treated as having established or maintained an ERISA plan. The Conference Committee Report states, however, that the conference agreement does not include the Senate amendment. Therefore, this issue of employers' exposure to ERISA fiduciary liability is not specifically addressed by the conference agreement, as described in the Conference Committee Report.

Committee Report at ¶ 14,025.

ALTERNATIVE MINIMUM TAX

Children Under Age 14

¶ 185

Background

Single taxpayers are entitled to an exemption from the alternative minimum tax (AMT) of $33,750. However, under prior law, the $33,750 AMT exemption amount that would otherwise apply to a single taxpayer was limited in the case of a child under age 14. The child's AMT exemption amount was limited to the amount of the child's earned income plus the greater of (1) the child's share of the "unused parental minimum tax exemption," which in essence was his share of his custodial parent's unused AMT exemption amount, or (2) twice the amount of the minor child's standard deduction (under Code Sec. 63(c)(5)(A)).

"Kiddie tax" AMT exemption amount indexed for inflation.—The alternative minimum tax (AMT) exemption amount for children under age 14 has effectively been increased and indexed for inflation. The AMT exemption amount in the case of a child under age 14 is equal to the lesser of $33,750 or the sum of the child's earned income plus $5,000 for tax years beginning in 1998. The $5,000 amount is indexed for inflation in post-1998 tax years. The determination of the child's AMT exemption amount is no longer dependent upon the computation of his parent's alternative minimum taxable income or AMT exemption amount.

Effective date. The increase and indexing of the "kiddie tax" AMT exemption amount applies to tax years beginning after December 31, 1997.

Act Sec. 1201(b), amending Code Secs. 59(j) and 6103(e)(1)(A)(iv); Act Sec. 1201(c). Law at ¶ 5035 and 5613. Committee Report at ¶ 12,120.

Chapter 2

Estate and Gift Tax and Trusts

UNIFIED CREDIT AND INFLATION ADJUSTMENTS

Unified Credit Increased

¶ 201

Background

Under prior law, a unified credit of $192,800 was available after 1986 for use against the gift tax on lifetime taxable gifts and the estate tax imposed on transfers at death. The unified credit effectively exempted the first $600,000 of cumulative taxable transfers.

Increase in unified estate and gift tax credit.—The previous unified credit amount is replaced by an "applicable credit amount" for the estates of

decedents dying, and gifts made, after 1997. The applicable credit amount is the amount of the tentative tax that would be determined under the rate schedule in Code Sec. 2001(c) if the amount with respect to which such tentative tax is to be computed were the "applicable exclusion amount." The applicable exclusion amount will be $1,000,000 in 2006 when fully phased in. Prior to being fully phased in, the applicable exclusion amount is $625,000 for decedents dying, and gifts made, in 1998; $650,000 in 1999; $675,000 in 2000 and 2001; $700,000 in 2002 and 2003; $850,000 in 2004; $950,000 in 2005; and $1,000,000 in 2006 or thereafter. There is no provision for adjusting the applicable exclusion amount for inflation after 2006.

Effective date. The provision is effective for estates of decedents dying, and gifts made, after December 31, 1997.

Act Sec. 501(a), amending Code Sec. 2010(a), redesignating Code Sec. 2010(c) as Code Sec. 2010(d), adding new Code Sec. 2010(c), and amending Code Secs. 2001(c)(2), 2102(c)(3)(A), 2505(a)(1), and 6018(a)(1). Law at ¶ 5417, 5419, 5439, 5455, and 5577. Committee Report at ¶ 10,365.

Inflation Adjustments

¶ 204

Background

Under prior law, there were no Code provisions providing for automatic cost-of-living adjustments to the Code Sec. 2503(b) annual gift tax exclusion or the Code Sec. 2032A(a)(2) limitation on the special use valuation reduction in fair market value. Similarly, there were no indexing provisions with respect to the Code Sec. 2631 GST tax exemption or the Code Sec. 6601 ceiling on the value of a closely held business eligible for the special low interest rate available when an executor elected to pay the estate tax in installments.

Cost-of-living adjustments for the annual exclusion for gifts, special use valuation, GST tax exemption and installment payment of taxes.—The $10,000 annual exclusion for gifts, the $750,000 ceiling on special use valuation, the $1,000,000 generation-skipping transfer (GST) tax exemption, and the $1,000,000 ceiling on the value of a closely held business eligible for the special low interest rate when an executor elects to pay the estate tax in installments will all be indexed annually for inflation after 1998.

Computing the cost-of-living adjustment. The cost-of-living adjustment to the annual exclusion for gifts, the ceiling on special use valuation, the GST tax exemption and the ceiling on the value of a closely held business eligible for the special low interest is the percentage, if any, by which the Consumer Price Index (CPI) for the preceding calendar year exceeds the CPI for calendar year 1997. Indexing of the annual gift exclusion is rounded to the next lowest multiple of $1,000 and indexing of the other amounts is rounded to the next lowest multiple of $10,000.

> **Example.** David Jones dies in 1999 and his estate elects special use valuation under Code Sec. 2032A with respect to his farm. The CPI for 1997 is 195.2000000000 and the CPI for 1998 is 200.4000000000. This results in an inflation adjustment factor of 1.0266393 (1998 CPI ÷ 1997 CPI). The maximum reduction in value of the specially valued farm that the estate is

entitled to is $760,000 calculated as follows: $750,000 × 1.0266393 = $769,979 or $760,000 rounded to next lowest $10,000.

PRACTICAL ANALYSIS. Sandy Schlesinger of Kaye, Scholer, Fierman, Hays & Handler, LLP, New York, notes that the Taxpayer Relief Act of 1997 increases the unified estate and gift tax credit over nine years, resulting in an exemption amount of $625,000 in 1998; $650,000 in 1999; $675,000 in 2000 and 2001; $700,000 in 2002 and 2003; $850,000 in 2004; $950,000 in 2005; $1,000,000 in 2006 and thereafter and caps the new family-owned business exclusion (see ¶ 215) at $1,300,000 annually *less* the applicable exemption amount (excludes $675,000 in 1998; $650,000 in 1999; $625,000 in 2000 and 2001; $600,000 in 2002 and 2003; $450,000 in 2004; $350,000 in 2005; and $300,000 in 2006 and thereafter).

Year	*Applicable Unified Credit (1)*	*Applicable "Exemption" Amount (2)*	*Business Exclusion Amount [$1.3 Million – (2)]*
1997	$192,800	$ 600,000	None
1998	$202,050	$ 625,000	$675,000
1999	$211,300	$ 650,000	$650,000
2000 and 2001	$220,550	$ 675,000	$625,000
2002 and 2003	$229,800	$ 700,000	$600,000
2004	$287,300	$ 850,000	$450,000
2005	$326,300	$ 950,000	$350,000
2006 and after	$345,800	$1,000,000	$300,000

For the tax years beginning *after* 1998 there are provisions for indexing the following for inflation (as of the 1997 cost-of-living adjustment): The $750,000 special use valuation under Code Sec. 2032A, the $10,000 annual exclusion for gifts, the $1,000,000 generation-skipping transfer tax exemption, and the $1,000,000 ceiling on the value of a closely held business eligible for a special low interest rate (under the new law, two percent).

The current unified credit amount came into effect in 1987. As can be seen, the new increases are phased in very slowly phased. Moreover, considering inflation, the tax savings will be modest even when the increase is fully phased in. For example, in the year 2006 when the increase in the unified credit is fully phased in, the new exemption amount will be $1,000,000. The savings with respect to a taxable estate of $1,000,000 (the minimum amount required to fully utilize the increased unified credit) or more would be $153,000 (with no adjustment for inflation since 1997). If the new family business exclusion is also fully utilized, there would be additional savings of $124,000. Thus, with respect to an estate of $1,300,000 (the minimum amount required to take full advantage of both the increased unified credit and the new family business exclusion) the maximum potential savings under the new rules (i.e., the increased unified credit and the new business exclusion) would be $277,000. On this basis, taking into account a husband and wife each of whom has a taxable estate of $1,300,000, total savings under the new rules would be $554,000. Obviously, this is not an insignificant amount, and taxpayers should plan their af-

fairs to achieve these savings, to the extent possible. Larger taxable estates could receive additional savings (above the $277,000 amount just described) because the business exclusion will effectively shield assets from the "top" of the estate where the otherwise applicable estate tax rates will be higher. Smaller estates (and taxable estates of any size that cannot utilize the family business exclusion and/or estates of decedents who die before 2006) will achieve less than $277,000 of savings. Therefore, the new rules do not represent a fundamental change in the current system.

These new provisions will also provide some savings in legal and/ or accounting fees and other administration expenses for modest estates which will no longer be required to file federal returns if they are less than the applicable increasing unified credit (not including the family business exclusion).

The phaseout of the unified credit is no longer fixed at a dollar amount of $21,040,000 but, instead, is now set at the amount at which the average tax rate is 55 percent.

Practitioners must carefully review and examine all wills and trusts to verify that the formula clauses relating to the unified credit will self-adjust to the phase-in amounts in each year. Where applicable, references to closely held businesses should be examined and formula clauses should be modified to take into account the new exclusion relating to family owned businesses. In addition, couples who have divided their assets so that each spouse has at least $600,000 may have to readjust their holdings.

All estate plans should be examined to consider whether, in addition to annual exclusion gifts, gifts should be made to utilize the additional amount of unified credit in 1998 and thereafter, with careful attention to those few jurisdictions (Connecticut, Louisiana, New York (repealed January 1, 2000), North Carolina, Tennessee, and Puerto Rico) which still have a state or local gift tax. The changes in the capital gain rates should also be considered in this regard, especially with respect to the substantial increase in the exclusion for gains on the sale of a residence, as it may no longer be advisable to wait until death to dispose of or sell appreciated assets or residences.

Taxpayers holding interests in small businesses and family owned farms may have to choose between the unified credit exemption and the business exclusion (see ¶ 215), which may create planning problems, especially if the business is intended to pass to one child and other estate assets to a different child, or to a spouse. As noted above, taking full advantage of the $1,300,000 exemption and exclusion could save as much as $277,000 in estate taxes. It has been pointed out by commentators that the new changes create an anomaly whereby the effective small business exclusion decreases each year as the exemption amount increases, thereby in effect decreasing the benefits of the small business exclusion from the greatest amount in 1998 dropping to the lowest amount in 2006.

Effective date. These provisions are effective for estates of decedents dying, and gifts made, after December 31, 1997.

Act Sec. 501(b), amending Code Sec. 2032A(a); Act Sec. 501(c), amending Code Sec. 2503(b); Act Sec. 501(d), adding new Code Sec. 2631(c); Act Sec. 501(e), redesignating Code Sec. 6601(j)(3) as Code Sec. 6601(j)(4) and adding new Code Sec. 6601(j)(3). Law at ¶ 5425, 5451, 5461, and 5685. Committee Report at ¶ 10,370.

GROSS ESTATE

Gifts from Revocable Trusts Within Three Years of Death

¶ 210

Background

Pursuant to Code Sec. 2038, a decedent's gross estate includes the value of any interest in property transferred, in trust or otherwise, if the decedent retained the power to alter, amend, revoke, or terminate the interest, or if such power was relinquished within three years of death. Similarly, the value of any interest in property transferred within three years of death that would have been included in the gross estate under Code Sec. 2038 or that would have been included in the gross estate if such interest had been retained by the decedent is includible in the decedent's gross estate under Code Sec. 2035. Thus, before the Taxpayer Relief Act of 1997, certain transfers from a decedent's revocable trust within three years of death were not treated as if made directly by the decedent. Therefore, the transfers, including annual exclusion gifts, from such trusts were includible in the decedent's gross estate. On the other hand, if, under the same circumstances, the decedent had revoked the trust or had the property transferred from the trust to himself or herself and then made the gift directly, the transferred property would not have been included in the transferor's gross estate.

Transfers treated as made directly by the decedent.—The value of property transferred to a donee from a decedent's revocable trust within three years of the decedent's death and the value of property in such a trust with respect to which the decedent's power to revoke is relinquished during the three years before death is not includible in the decedent's gross estate. A revocable trust is a trust treated under Code Sec. 676 as owned by the decedent. Transfers from such a trust are treated as if made directly by the decedent for purposes of Code Sec. 2035 and Code Sec. 2038. Accordingly, an annual exclusion gift from a revocable trust is not included in the decedent's gross estate. This change codifies the rules in *H. McNeely*, CA-8, 94-1 USTC ¶ 60,155, 16 F3d 303, and *E. Kisling Est.*, CA-8, 94-2 USTC ¶ 60,176, 32 F3d 1222.

Effective date. These provisions are effective for the estates of decedents dying after August 5, 1997.

Act Sec. 1310, amending Code Sec. 2035. Law at ¶ 5429. Committee Report at ¶ 12,660.

Short-Term Obligations Held by Nonresident Aliens

¶ 212

Background

Generally, debt obligations of a U.S. person, the United States, or a political subdivision of a state that are held by a nonresident noncitizen are considered to be property located within the United States. Accordingly, such debt obligations are subject to federal estate tax if held at death. However, Code Sec. 2105(b) provides special rules to exclude certain bank deposits and debt instruments from the gross estate of a nonresident noncitizen. These items are also exempt from U.S. income tax under Code Sec. 871(h) and Code Sec. 871(i)(2)(A). After passage of an amendment to Code Sec. 871(h) by the Tax Reform Act of 1986 (P.L. 99-514) and prior to the Taxpayer Relief Act of 1997, the estate tax exception did not apply to debt obligations that generated short-term original issue discount (OID) income. This resulted in unequal treatment of these debt obligations for U.S. estate tax and income tax purposes.

Short-term obligations treated as property outside U.S.—U.S. debt obligations held by nonresident noncitizens that produce short-term original issue discount income will be treated as property located outside the United States for purposes of the U.S. estate tax imposed on such individuals. Accordingly, qualified debt obligations will not be included in a nonresident noncitizen's gross estate.

Planning Note. This provision serves to equalize the U.S. income tax and estate tax treatment of short-term debt obligations held by nonresident aliens. In doing so, a potential death tax trap for nonresident aliens is removed while the ability of U.S. borrowers to raise money from foreign sources is enhanced.

Effective date. The provision is effective with respect to estates of decedents dying after August 5, 1997.

Act Sec. 1304, adding Code Sec. 2105(b)(4). Law at ¶ 5441. Committee Report at ¶ 12,630.

Land Subject to a Qualified Conservation Easement

¶ 214

Background

A contribution of a qualified real property interest to a charity or other qualified organization exclusively for conservation purposes qualifies for an estate and gift tax deduction under Code Sec. 2055(f) and Code Sec. 2522(d), respectively. However, in order to qualify for the deduction for a conservation contribution, the donor was not allowed to retain an interest in minerals which could be extracted or removed by any surface mining method unless (1) the surface and mineral estates in the property with respect to which the contribution was made were separated before June 13, 1976, and (2) the probability of surface mining on the property with respect to which the contribution was made was so remote as to be negligible. No provision previously existed that allowed an estate to exclude a portion of the value of land subject to a conservation easement from the gross estate.

Estate tax treatment of land subject to a qualified conservation easement.—A charitable deduction is allowed for estate and gift tax purposes for a

contribution of a qualified real property interest to a charity exclusively for conservation purposes. If an executor so elects, a new Code provision allows an exclusion from a decedent's gross estate of up to 40 percent (the "applicable percentage") of the value of land subject to a qualified conservation easement, reduced by the amount of any charitable deduction under Code Sec. 2055(f) with respect to the land. The maximum amount that can be excluded is the lessor of the applicable percentage or the "exclusion limitation." The exclusion limitation is \$100,000 in 1998, \$200,000 in 1999, \$300,000 in 2000, \$400,000 in 2001, and \$500,000 in 2002 or thereafter. This exclusion is in addition to the new qualified family-owned business exclusion provided under Code Sec. 2033A and described at ¶ 215.

The election is made on the estate tax return and, once made, is irrevocable. Land subject to a qualified conservation easement is land that is located (1) in or within 25 miles of a metropolitan area as defined by the Office of Management and Budget, (2) in or within 25 miles of a national park or wilderness area, unless the Secretary determines that such land is not under significant development pressure, or (3) in or within 10 miles of an Urban National Forest as designated by the Forest Service of the U.S. Department of Agriculture. In addition, the land must have been owned by the decedent or a member of the decedent's family during the three-year period ending on the date of the decedent's death. Further, the land must be subject to a qualified conservation easement granted by the decedent or a member of the decedent's family. However, a post-mortem conservation easement may be placed on the property, provided the easement has been made no later than the date of the election. The Code Sec. 2032A(e)(2) definition of member of the family applies. The transferee of land subject to a conservation easement that is acquired at death receives a carryover basis, to the extent that the value of land is excluded from the taxable estate.

Debt-financed property is eligible for the exclusion to the extent of the net equity in the property. Debt-financed property means property with respect to which there is an acquisition indebtedness on the date of the decedent's death. Acquisition indebtedness includes (1) indebtedness incurred by the donor in acquiring the property, (2) indebtedness incurred before the acquisition of the property if such indebtedness would not have been incurred but for such acquisition, (3) indebtedness incurred after the acquisition of the property if such indebtedness would not have been incurred but for such acquisition, and the incurrence of the indebtedness was reasonably foreseeable at the time of acquisition, and (4) the extension, renewal, or refinancing of an acquisition indebtedness.

Qualified conservation easement. A qualified conservation easement is a qualified conservation contribution, as defined in Code Sec. 170(h)(1). It is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest means a restriction, granted in perpetuity, on the use that may be made of the real property. Conservation purposes are defined in Code Sec. 170(h)(4)(A). However, for purposes of the qualified conservation easement exclusion, the preservation of a historically important land area or a historic structure does not qualify as a conservation purpose. In addition, a *de minimis* commercial recreational activity that is consistent with the conservation purpose, such as the granting of hunting and fishing licenses, will not cause the property to fail to qualify for the exclusion. The Conference Committee Report anticipates that the Secretary of the Treasury will provide guidance regarding the definition of *de minimis* activities.

Exclusion amount. The exclusion amount is calculated based on the value of the property after the conservation easement has been placed on the property. In addition, the exclusion amount does not extend to the value of any development rights retained by the decedent or the donor. Development rights are defined as any rights retained to use the land for any commercial purpose which is not subordinate to and directly supportive of the land as a farm or for farming purposes within the meaning of Code Sec. 2032A(e)(5). However, if every person in being who has an interest in the land executes an agreement to extinguish permanently some or all of any development rights retained by the donor, on or before the estate tax return is due, the estate tax may be reduced accordingly. If the agreement is not implemented by the earlier of the date which is two years after the decedent's death or the date of the sale of the land, an additional tax is imposed in the amount of the tax which would have been due on the retained development rights that were subject to the agreement.

Applicable percentage. The applicable percentage means 40 percent reduced (but not below zero) by two percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30 percent of the value of the land. For this purpose, the value of the land is determined without regard to the value of the easement, and reduced by the value of any retained development rights. As a result, if the value of the easement is 10 percent or less of the value of the land before the easement, less the value of any retained development rights, the applicable percentage will be zero.

> **Example.** Diane Jones died owning land subject to a qualified conservation easement. She did not retain any development rights in the property. The fair market value of the real property on the date of death was $500,000 without the conservation easement and $400,000 with the easement. Thus, the value of the conservation easement is $100,000 or 20 percent of the value of real property without the easement. The applicable percentage for the estate is 20 percent (40 percent reduced by twice the difference between 30 percent and 20 percent). Therefore, the exclusion amount is $80,000 (20 percent of $400,000).

Special-use valuation property. The granting of a conservation easement does not affect specially-valued property under Code Sec. 2032A. Thus, the granting of a such an easement is not treated as a disposition for purposes of Code Sec. 2032A(c) and does not trigger the additional estate tax. In addition, the existence of a qualified conservation easement does not prevent the property from subsequently qualifying for special use valuation.

Retained mineral interests. A contribution of a permanent conservation easement on property qualifies for a charitable deduction for estate and income tax purposes where a mineral interest has been retained and surface mining is possible, but its probability is so remote as to be negligible. Under prior law, a charitable deduction was available to such a contribution only if the mineral interests were separated from the land prior to June 13, 1976.

Effective date. The estate tax exclusion for land subject to a permanent conservation easement and the amendment to the carryover basis rules are effective for the estates of decedents dying after December 31, 1997. The rules with respect to conservation easement under Code Sec. 2032A and with respect to

retained mineral interests are effective for easements granted after December 31, 1997.

Act Sec. 508(a), redesignating Code Sec 2031(c) as Code Sec. 2031(d) and adding new Code Sec. 2031(c); Act Sec. 508(b), adding new Code Sec. 1014(a)(4); Act Sec. 508(c), adding new Code Sec. 2032A(c)(8); and Act Sec. 508(d), amending Code Sec. 170(h)(5)(B)(ii); Act. Sec. 508(e). Law at ¶ 5077, 5315, 5423, and 5425. Committee Report at ¶ 10,420.

QUALIFIED FAMILY-OWNED BUSINESS

Family-Owned Business Exclusion

¶ 215

Background

Before the Taxpayer Relief Act of 1997, there was no special estate tax provision that excluded a portion of a qualified family-owned business from a decedent's gross estate. However, all decedent's were entitled to a unified credit of $192,800 for lifetime gifts and transfers at death. The unified credit effectively exempted $600,000 in cumulative transfers from estate and gift taxes.

Qualified family-owned business exclusion.—If an estate qualifies, there is excluded from a decedent's gross estate the lesser of (1) the adjusted value of the decedent's qualified family-owned business interests or (2) the excess of $1,300,000 over the applicable exclusion amount in effect with respect to the decedent's estate. Thus, in 1998 when the applicable exclusion amount is $625,000, a maximum of $675,000 of adjusted value of the decedent's qualified family-owned business interests could be excluded from the gross estate. Therefore, only the value of qualified family-owned business interests in excess of $1,300,000 is subject to the estate tax in the decedent's estate. In general, to qualify for the exclusion the aggregate value of the decedent's qualified family-owned business interests that are passed to qualified heirs must exceed 50 percent of the decedent's adjusted gross estate. In addition, the decedent must be a U.S. citizen or resident at the time of death, the executor must elect special tax treatment and file a recapture agreement signed by each person in being having an interest in the property, and certain other requirements must be met. This exclusion is in addition to the effective exemption provided by the unified credit, the special use valuation provisions, and the provisions for the installment payment of estate taxes attributable to a closely-held business.

Ownership requirement. A qualified family-owned business is any interest in a trade or business, regardless of form, with a principal place of business in the United States, the ownership of which is held (1) at least 50 percent by one family, (2) 70 percent by two families, or (3) 90 percent by three families. If held by more than one family, the decedent's family must own at least 30 percent of the trade or business. Members of the individual's family include (1) the individual's spouse, (2) the individual's ancestors, (3) lineal descendants of the individual, of the individual's spouse, or of the individual's parents, and (4) the spouse's of any such lineal descendants.

In the case of a corporation, the ownership test is met if the decedent and family members own the requisite percentage of *both* the total combined voting power of all classes of voting stock *and* the total value of all shares of all classes of stock. In the case of a partnership, the decedent and family members are required

to own the requisite percentage of the capital interest in the partnership (note that the Senate Committee Report also indicates an ownership requirement in the *profits interest* of a partnership). Special look-through rules apply in the case of a trade or business that owns an interest in another trade or business. Whether owned directly or indirectly, each trade or business owned by the decedent and members of the family must be separately tested to determine whether the trade or business meets the requirement's of a qualified family-owned business.

Caution. An interest in a trade or business does not qualify if the business's, or a related entity's, stock or securities were publicly-traded at any time within three years of the decedent's death. In addition, the interest does not qualify if more than 35 percent of the adjusted ordinary gross income from the business for the year of the decedent's death was personal holding company income. The second restriction does not apply to banks and domestic building and loan associations.

Valuation. The value of a trade or business qualifying as a family-owned business interest is reduced to the extent that the business holds certain passive assets or cash and marketable securities in excess of the reasonably expected day-to-day working capital need for the trade or business. The Senate Conference Report anticipates that the historic average of a business's working capital needs in the past would provide the basis for determining working capital needs of the business, using an analysis similar to that used in *Bardahl Mfg. Corp.*, 24 TCM 1030, CCH Dec. 27,4949, TC Memo. 1965-200. In addition, accumulations for capital acquisitions is not considered "working capital." Further, certain other passive assets are not considered in valuing qualified family-owned business interests.

The following assets are considered passive assets and are not included in the value of a qualified family-owned business:

(1) assets that produce dividends, interest, rents, royalties, annuities and Code Sec. 543(a) personal holding company income;

(2) assets that are interests in a trust, partnership or real estate mortgage investment conduit (REMIC) (as described in Code Sec. 954(c)(1)(B)(ii));

(3) assets that produce no income (as described in Code Sec. 954(c)(1)(B)(iii));

(4) assets that give rise to income from commodities transactions or foreign currency gains (as described in Code Sec. 954(c)(1)(C) and (D));

(5) assets that produce income equivalent to interest (as described in Code Sec. 954(c)(1)(E)); and

(6) assets that produce income from notional principal contracts or payments in lieu of dividends (as described in new Code Sec. 954(c)(1)(F) and (G)).

However, with respect to regular dealers in property, such property is not considered to produce passive income and, therefore, is not considered a passive asset.

Qualifying estates. In order to qualify for special treatment, the decedent must have been a U.S. citizen or resident at the time of death, and the aggregate value of the decedent's qualified family-owned business interests that are passed to qualified heirs must exceed 50 percent of the decedent's adjusted gross estate. For this purpose, qualified heirs include any individual who was actively employed by the trade or business for at least 10 years prior to the date of the decedent's death,

as well as members of the decedent's family. The decedent's qualified family-owned business interests passing to qualified heirs includes lifetime gifts of such interests made by the decedent to members of the decedent's family to the extent that those interests are held by family members (other than the decedent's spouse) between the date of the gift and the date of the decedent's death. Generally, a 50-percent liquidity test is used to determine if this requirement is met. Under this test, the total of all transfers of qualified family-owned business interests made by the decedent to qualified heirs at the time of the decedent's death, plus certain lifetime gifts to family members, is compared to the decedent's adjusted gross estate. If the decedent held qualified family-owned business interests in more than one trade or business, all such interests are aggregated for purposes of applying the 50-percent liquidity test.

50-percent liquidity test. To determine whether the decedent's qualifying interests comprise more than 50 percent of the decedent's adjusted gross estate, a percentage calculation using the following numerator and denominator is used.

The numerator is determined by aggregating the value of all qualified family-owned business interests that are includible in the decedent's gross estate and are passed from the decedent to a qualified heir, plus any lifetime transfers of such interests by the decedent to members of the decedent's family (other than the decedent's spouse), provided such interests have been continuously held by members of the family and were not otherwise includible in the decedent's gross estate. For this purpose, the qualified interests transferred to members of the family during the decedent's lifetime are valued as of the date of the transfer. This amount is then reduced by all the indebtedness of the estate, except for the following:

(1) indebtedness on a qualified residence of the decedent, i.e., a residence that qualifies for the mortgage interest deduction under Code Sec. 163(h)(3);

(2) indebtedness incurred to pay the educational or medical expenses of the decedent, the decedent's spouse, or the decedent's dependents; and

(3) other indebtedness of up to $10,000.

The denominator is equal to the decedent's gross estate, reduced by any indebtedness of the estate and increased by the amount of the following transfers, to the extent not already included in the gross estate:

(1) lifetime transfers of qualified business interests that were made by the decedent to members of the decedent's family (other than the decedent's spouse), provided such interests were continuously held by members of the family; plus

(2) transfers, other than *de minimis* transfers, from the decedent to the decedent's spouse that were made within 10 years of the date of the decedent's death; plus

(3) any other transfers made by the decedent within three years of death, except nontaxable transfers made to members of the decedent's family.

Planning Note. While consideration should be given, if necessary, to reducing the nonbusiness assets in the gross estate during the decedent's lifetime in order to qualify for the family-owned business exclusion, advanced planning is required. Transfers to the decedent's spouse will not be effective unless made more than 10 years before the decedent's death and transfers to others, except nontaxable

transfers to members of the decedent's family, must occur more than three years before the decedent's death.

Participation requirements. The decedent, or members of the decedent's family, must have owned and materially participated in the trade or business for at least five of the eight years preceding the decedent's death in order to qualify for special treatment. In addition, a qualified heir is subject to a recapture tax if the heir, or a member of the qualified heir's family, does not materially participate in the trade or business for at least five years of any eight-year period within 10 years following the decedent's death. The definition of "material participation" provided in Code Sec. 2032A and the regulation thereunder pertaining to special use valuation apply. Accordingly, the principal factors to be considered include physical work and participation in management decisions. Note that the Senate Committee Report states that the material participation requirement will be met with respect to a qualified heir if the heir rents qualified property to a member of the qualified heir's family on a net cash basis, and that family member materially participates in the business.

Recapture tax. An additional tax is imposed if any of the following recapture events occur within 10 years of the decedent's death and before the qualified heir's death:

(1) the qualified heir ceases to meet the material participation requirements;

(2) the qualified heir disposes of any portion of his or her interest in the family-owned business, other than by a disposition to a member of the qualified heir's family or through a conservation contribution under Code Sec. 170(h);

(3) the principal place of business of the trade or business ceases to be located in the United States; or

(4) the qualified heir loses U.S. citizenship.

The Conference Committee Report indicates that the sale or disposition of assets such as inventory or a piece of equipment used in the business in the ordinary course of the business will not trigger the recapture tax.

The recapture tax may be avoided if a qualified heir loses U.S. citizenship, provided the trade or business assets are placed into a qualified trust meeting requirements similar to a qualified domestic trust (QDOT) under Code Sec. 2056A(a) or certain other security arrangements are met. The recapture period may be extended up to two years if the qualified heir does not begin to use the property for a period of up to two years after a decedent's death.

The recapture tax is a personal liability of each qualified heir to the extent of the portion of the additional tax that is imposed with respect to his or her interest in the qualified family-owned business.

Example. John, Beth, and Sue Ingram, inherit equal qualified family-owned business interests from their father, and the father's estate elects special tax treatment under Code Sec. 2033A. Only Sue continues to materially participate in the family business. Such participation, as a family member, causes all three children to meet the participation requirements. However, during the fourth year following the decedent's death, Sue ceases to materially participate in the business and neither John or Beth participates.

As a result, each of the three children would be personally liable for the portion of the recapture tax attributable to his or her interest.

Amount of additional estate tax. The additional estate tax is based upon when the recapture event occurs in relation to the decedent's death. If the recapture event occurs within the first six years of material participation, 100 percent of the reduction in estate tax attributable to the heir's interest is recaptured. Thereafter, the applicable percentage is 80 percent in the seventh year, 60 percent in the eighth year, 40 percent in the ninth year, and 20 percent in the tenth year.

PRACTICAL ANALYSIS. Arthur Sederbaum of Patterson, Belknap, Webb & Tyler LLP, New York, notes that new Code Sec. 2033A has been added by the Act providing that, for estates of decedents dying after December 31, 1997, the executor may elect to exclude the value of certain "qualified family-owned business interests" from the decedent's gross estate. The exclusion may be taken only to the extent that the sum of the exclusion plus the amount of the decedent's taxable estate necessary to generate the maximum unified credit does not exceed $1,300,000. Thus, as the unified credit amount is phased in from 1998 through 2006 and later, the exclusion for family-owned businesses decreases from 1998 through 2006 and later.

In order to be eligible, the value of the qualified family-owned business interests owned at the decedent's death, plus the value of any gifts of such interests made by the decedent during his lifetime to members of his family must exceed 50 percent of the decedent's adjusted gross estate. The term "adjusted gross estate" has a unique definition under new Code Sec. 2033A. It means the decedent's gross estate as reduced only by deductible claims and mortgages under Code Sec. 2053(a)(3) and (a)(4) (but not the deductions allowed for funeral and administration expenses under Code Sec. 2053(a)(1) and (a)(2)), and as increased by the amount of inter vivos gifts not otherwise includible in the decedent's gross estate of (i) qualified family-owned business interests made by the decedent to members of her family, (ii) the amount of any transfers made by the decedent to her spouse within 10 years of the date of the decedent's death, and (iii) the amount of all other gifts made by the decedent within three years of her death (other than gifts which qualify for the annual gift tax exclusion under Code Sec. 2503(b)).

A qualified family-owned business interest is defined as either an interest in a trade or business carried on as a sole proprietorship or an interest in an entity (corporation, partnership or LLC) carrying on a trade or business, provided that ownership of the entity is held at least 50 percent by one family, 70 percent by two families, or 90 percent by three families and provided that the decedent's family owns at least 30 percent of the business interest. The term "member of the family" has the same meaning as in Code Sec. 2032A(e)(2), which is the individual's ancestors, spouse, lineal descendants, spouse's lineal descendants, the spouse of any lineal descendant, and any lineal descendant of the individual's parents. Many other definitions in the new family-owned business exclu-

sion section are borrowed from Code Sec. 2032A. Practitioners who considered Code Sec. 2032A to be narrow in scope and not worthy of attention will now be compelled to master the numerous definitions in that section which are applicable to new Code Sec. 2033A.

There are two keys for qualification for the family-owned business exclusion. First, the interest must be in an entity which carries on a trade or business. Here the regulations, cases and rulings under Code Sec. 6166 will be instructive. Second, the decedent or a member of the decedent's family must have owned and materially participated in the business for five of the eight years prior to the date of the decedent's death, and a qualified heir must have continued material participation for 10 years after the date of the decedent's death. An additional estate tax is imposed if the material participation requirements are not met for the 10-year period following the decedent's death or if the qualified heir disposes of any portion of the interest, other than by transfer to a member of the qualified heir's family. Again, reference is made to Code Sec. 2032A for the definitions of "material participation," and "qualified heir." The fact that the material participation requirement may be satisfied by a member of the decedent's family means that a nonparticipating spouse who owns an interest in the business may also take advantage of the exclusion.

Since 1995, when then-Senator Dole introduced the first measure covering estate tax relief for family-owned businesses, there has been a significant movement in Congress for the enactment of such a measure. Therefore, it is difficult to fathom why the Act ties the family-owned business exclusion to the unified credit amount in an inverse relationship. The impact of the exclusion is thus at its greatest in 1998, and diminishes significantly in 2006 and thereafter. The relationship between the two provisions will create difficulties for those individuals who have, for example, one child in the business and one or more who are not. It is hoped that future legislation will widen the impact of the exclusion and make it independent of the unified credit.

Effective date. The qualified family-owned business exclusion is effective for the estates of decedents dying after December 31, 1997.

Act Sec. 502, adding Code Sec. 2033A. Law at ¶ 5427. Committee Report at ¶ 10,375.

INSTALLMENT PAYMENTS AND INTEREST

Judicial Review of Installment Payment Eligibility

¶ 225

Background

Estates of decedents dying on or before the date of enactment of the Taxpayer Relief Act of 1997 (August 5, 1997) that were determined not to be eligible for estate tax relief under the installment payment provisions of Code Sec. 6166, or that were declared to have lost their eligibility, had limited access to judicial

Background

review. Estates so impacted were forced to pay any estate tax due before seeking such review.

Eligibility for installment payment of estate tax subject to declaratory judgment.—The estate of a decedent that is denied relief under Code Sec. 6166, pertaining to the installment payment of estate tax, is entitled to seek a declaratory judgment before the Tax Court as to the estate's eligibility for installment payments. This provision applies to both the initial and continued eligibility for installment payment treatment. Provided the IRS's adverse determination is sent by certified or registered mail, a pleading made pursuant to this provision must be filed within 90 days of the mailing.

In order to be eligible for judicial review under this provision, the estate must show that it exhausted all administrative remedies within the IRS. A petitioner will be deemed to have exhausted all available administrative remedies if the IRS fails to make a determination within 180 days of a request for determination, providing all reasonable steps to secure such determination have been made.

Planning Note. Estates that seek installment payment treatment are ordinarily at a financial disadvantage as a result of lack of liquidity. Accordingly, the availability of judicial review of an adverse determination on the issue of eligibility for installment payment of estate taxes without first having to pay the full amount of estate taxes due should prove beneficial to estates with qualified closely held business interests.

Effective date. The provision is effective with respect to estates of decedents dying after August 5, 1997.

Act Sec. 505, adding Code Sec. 7479. Law at ¶ 5731. Committee Report at ¶ 10,390.

Interest on Estate Tax

¶ 227

Background

Under prior law, Code Sec. 6601(j) provided a special four-percent rate of interest on a certain portion of the estate tax on a closely held business if an executor elected to pay the tax in installments under Code Sec. 6166. This special low interest rate applied to the amount of deferred estate tax attributable to the first $1,000,000 in value of a closely held business only. The amount of estate tax payable in installments that exceeded the amount subject to the four-percent rate was subject to interest at the Code Sec. 6621 underpayment rate. This underpayment rate is the federal short-term rate plus three percentage points. In addition, the interest paid on the deferred payments was a deductible expense for estate or income tax purposes. However, the interest was only deductible as it accrued, thereby requiring the annual filing of a supplemental estate tax return and complex computations in order to claim the estate tax deduction.

Reduced interest on installment payments.—Interest at the rate of two percent is imposed on the "two-percent portion," i.e., the first $1,000,000 in *taxable* value, of estate tax attributable to a closely held business when an estate elects the Code Sec. 6166 extension of time for payment of the estate tax. In

addition, the interest rate imposed on the amount of the deferred estate tax attributable to the taxable value of the closely held business in excess of the two-percent portion is reduced to an amount equal to 45 percent of the rate applicable to underpayments of tax.

Two-percent portion. The two-percent portion is an amount equal to the amount of the tentative estate tax on ($1,000,000 + the applicable exclusion amount in effect) minus the applicable credit amount in effect. However, if the amount of estate tax extended under Code Sec. 6166 is less than the amount computed above, the two-percent portion is the lesser amount. Thus, in 1998, the two-percent portion is the estate tax attributable to the value of the closely held business between $625,000 and $1,625,000.

> **Example.** Bob Putnam dies in 1998 when the applicable exclusion amount is $625,000. The estate tax value of Bob's interest in a closely held business is valued at $2,000,000 and the executor of his estate elects, pursuant to Code Sec. 6166, to extend the time for payment of the estate taxes. The amount of estate tax attributable to the value of the closely held business between $625,000 and $1,625,000 is eligible for the two-percent interest rate. The two-percent portion is $410,000, computed as follows: a $612,050 tentative estate tax on $1,625,000 ($1,000,000 + applicable exclusion amount in effect in 1998) minus $202,050 (the applicable credit amount in effect in 1998) equals $410,000. The interest rate imposed on the portion of the deferred estate tax in excess of the $410,000 is equal to 45 percent of the rate applicable to underpayments of tax.

No deductions allowed. No deduction is allowed for estate tax or income tax purposes for the interest paid on estate taxes deferred under Code Sec. 6166.

Election. If the estate of a decedent who died before 1998 elected installment payments under Code Sec. 6166, the executor of the estate may make an irrevocable election to have the amendments made by Section 503 of the Taxpayer Relief Act of 1997 apply to the installments payments that are due after the effective date of this election. However, if this election is made, the two-percent rate will only apply to the amount that was previously eligible for the four-percent rate. The estate will not receive the benefit of the increase in the amount eligible for the Code Sec. 6601(j) interest rate. The election must be made before January 1, 1999, in the manner prescribed by the Secretary of the Treasury.

Caution. If the one-time election is made to use the lower interest rates, the estate will forgo the interest deduction for installments due after the date of the election.

Effective date. The two-percent interest and reduced interest provisions are effective for the estates of decedents dying after December 31, 1997.

Act Sec. 503(a), amending Code Sec. 6601(j)(1) and (j)(2); Act Sec. 503(b), adding new Code Sec. 2053(c)(1)(D), amending Code Sec. 163(h)(2)(E), redesignating Code Sec. 163(k) as Code Sec. 163 (l), adding new Code Sec. 163(k); Act Sec. 503(c), amending Code Sec. 6166(b)(7)(A)(iii) and (8)(A)(iii) and Code Sec. 6601(j)(4). Law at ¶ 5069, 5431, 5617, and 5685. Committee Report at ¶ 10,380.

SPECIAL USE VALUATION

Cash Leases of Specially Valued Property

¶ 229

Background

Prior to the Taxpayer Relief Act of 1997, only a surviving spouse could rent specially valued property on a net cash basis without triggering the recapture tax. Under Code Sec. 2032A, an executor may elect to value certain qualified real property used in farming or other qualifying trade or business at its current use value rather than at its highest and best use value. If special use valuation is elected, the qualified heir is subject to an additional tax if he or she disposes of any interest in qualified real property or ceases to use the property for its qualified use within 10 years (15 years for individuals dying before 1982) following the decedent's death. A cessation of qualified use occurs if there is no material participation by the qualified heir or any member of the heir's family in the operation of the farm or other business. Leasing qualified real property on a net cash basis is generally considered a cessation of qualified use because the heir no longer bears the financial risks of the business. However, a special provision provides that a surviving spouse shall not be treated as failing to use qualified real property for a qualified use if such spouse rents property to a member of the spouse's family on a net cash basis.

Cash lease by lineal descendant of the decedent.—Lineal descendants of the decedent may lease specially valued real property to a member of the lineal descendant's family on a net cash basis without subjecting such individual to the recapture tax. A lineal descendent will not be treated as failing to use the qualified real property in a qualified use solely because the individual rents such property to members of his or her family on a net cash lease basis. Members of the lineal descendant's family include that individual's (1) ancestors, (2) spouse, (3) lineal descendants of the individual, of the individual's spouse, or of a parent of such individual, or (4) the spouse of any lineal descendant in (3) above. This rule is similar to the special rule that is currently available to a surviving spouse.

> **Example.** Jane Nortell inherits a farm from her father for which a special use valuation election is made, and she rents the farm to an unrelated neighbor on a crop share basis. Three years after her father's death, Nortell leases the qualified real property to her nephew on a net cash basis and the nephew continues to operate the farm. The lease of the farm to Nortell's nephew does not result in a cessation of qualified use because Nortell is a lineal descendant of the decedent and her nephew is a lineal descendant of her parent. Thus, Nortell's nephew is a member of the family.

Planning Note. Because the provisions allowing qualified heirs to cash lease specially valued property are retroactive, estates that were previously required to pay the recapture tax may be entitled to a refund if the statute of limitations for filing a claim has not expired. Those estates that would have been liable for the recapture tax under prior law will no longer be subject to the recapture tax for unreported cash leasing arrangements that qualify under the present law. There is no special provision in the Taxpayer Relief Act of 1997 providing a time frame within which a refund of previously paid recapture taxes with respect to cash leasing by a qualified heir may be obtained.

Effective date. The provision treating certain rents as a qualified use is effective with respect to leases entered into after December 31, 1976.

Act Sec. 504, adding new Code Sec. 2032A(c)(7)(E) and amending Code Sec. 2032A(b)(5)(A). Law at ¶ 5425. Committee Report at ¶ 10,385.

Correction of Election Statement

¶ 231

Background

An executor may elect to value certain real property used for farming or other qualified businesses at its current use value rather than its highest and best use value under Code Sec. 2032A. In order to make a valid election, certain information is required to be included in the notice of election and each person who has an interest in the property is required to sign an agreement consenting to the imposition of additional estate tax in the event of a failure to use the property for its qualified use within 10 years of the decedent's death. If an election is timely filed and (1) the notice of election does not contain all of the required information or (2) the signature of one or more persons required to sign the agreement is missing or the agreement does not contain all the required information, the executor may provide the missing information or signatures within 90 days of being notified by the IRS. However, before the Taxpayer Relief Act of 1997, modification of the election and agreement to provide missing information or signatures was only permitted if the original election had substantially complied with the applicable regulations.

Modification of election and agreement.—The requirement that an executor electing special use valuation must have substantially complied with the regulations in order to be entitled to submit missing information or signatures has been deleted from Code Sec. 2032A(d)(3). If the executor submits a timely notice of election and recapture agreement, but the election or agreement does not contain all the required information or signatures, the executor may supply the missing information or signatures within 90 days of being notified by the IRS, without regard to compliance with the regulations.

Effective date. This right to correct certain failures is effective for the estates of decedents dying after August 5, 1997.

Act Sec. 1313, amending Code Sec. 2032A(d)(3). Law at ¶ 5425. Committee Report at ¶ 12,675.

QUALIFIED DOMESTIC TRUSTS

Withholding Requirement

¶ 233

Background

For decedents dying after November 10, 1988, the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) (P.L. 100-647), denies a marital deduction for transfers to a surviving spouse who is not a U.S. citizen unless the transfer is made to a qualified domestic trust (QDOT). TAMRA also required that *all* trustees of a QDOT be U.S. citizens or domestic corporations. A subsequent modification made by the Revenue Reconciliation Act of 1990 (P.L. 101-508) stated that *at least one*

Background

trustee must be a U.S. citizen or domestic corporation and that no distribution of corpus may be made unless such trustee has the right to withhold any estate tax imposed on the distribution. The effect of the latter modification was to force the revision of estate planning documents drafted pursuant to the TAMRA provision that did not include the withholding requirement although, even under the earlier rule, a trustee was liable for any estate tax due with respect to a QDOT.

QDOT withholding rule clarified.—A qualified domestic trust (QDOT) drafted in response to changes in the marital deduction rules for transfers to a noncitizen spouse, as made by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) (P.L. 100-647), will be deemed to satisfy the withholding requirement if the governing instrument provides that all trustees be U.S. citizens or domestic corporations.

Planning Note. Under the transitional rule, wills and trusts drafted in conformity with the TAMRA requirements for QDOTs, but that do not include the withholding requirement subsequently imposed by the Revenue Reconciliation Act of 1990 (P.L. 101-508), do not have to be revised.

Effective date. The provision is effective with respect to decedents dying after November 10, 1988.

Act Sec. 1303, amending Act Sec. 11702(g) of the Revenue Reconciliation Act of 1990. Law at ¶ 5437. Committee Report at ¶ 12,625.

Arrangements Similar to Trusts

¶ 235

Background

The marital deduction is available for property passing to a surviving spouse who is not a U.S. citizen only if the property passes to the spouse in a qualified domestic trust (QDOT). Under prior law, the definition of a QDOT was limited to a trust that (1) required that at least one trustee of the trust be an individual citizen of the United States or a domestic corporation and (2) provided that no distributions could be made from the trust unless such trustee had the right to withhold the estate tax from such distribution. However, trusts are not authorized in some countries, particularly those governed by civil law. Accordingly, in those jurisdictions the marital deduction would not be available. In addition, in some countries trusts may not have U.S. trustees (see ¶ 237). Therefore, a trust established in such countries could not qualify as a QDOT.

QDOT rules for forms of ownership that are not trusts.—In order to permit the estate of a decedent with a nonresident alien spouse to qualify for the marital deduction in those situations where the use of a trust is prohibited, the Treasury Department is granted regulatory authority to treat as trusts legal arrangements that have substantially the same effect as a trust.

Planning Note. The House Committee Report anticipates that such regulations would permit a marital deduction only with respect to nontrust arrangements under which the United States would retain jurisdiction and adequate security to impose a U.S. transfer tax on transfers by the surviving spouse of the property transferred by the decedent. According to the Committee report, a closing agree-

ment process under which the surviving spouse waives treaty benefits, allows the United States to retain jurisdiction and provides adequate security could be one such arrangement.

Effective date. This provision is effective for the estates of decedents dying after August 5, 1997.

Act Sec. 1312(a), adding new Code Sec. 2056A(c)(3). Law at ¶ 5437. Committee Report at ¶ 12,670.

Requirement of U.S. Trustee

¶ 237

Waiver of requirement of U.S. trustee for QDOT.— In order to qualify for the marital deduction in those situations where a country prohibits a trust from having a U.S. trustee, the Treasury Department is granted regulatory authority to waive the requirement that a qualified domestic trust (QDOT) have a U.S. trustee.

Planning Note. The House Committee Report anticipates that such regulations, if any, would provide an alternative mechanism under which the United States would retain jurisdiction and adequate security to impose U.S. transfer tax on transfers by the surviving spouse of the property transferred by the decedent. A closing agreement process under which the surviving spouse waives treaty benefits, allows the U.S. to retain taxing jurisdiction, and provides adequate security with respect to the transfer tax could be one possible mechanism.

Effective date. This waiver provision is effective for the estates of decedents dying after August 5, 1997.

Act Sec. 1314, amending Code Sec. 2056A(a)(1)(A). Law at ¶ 5437. Committee Report at ¶ 12,680.

MARITAL DEDUCTION

Survivor Annuities

¶ 239

Background

Under the Retirement Equity Act of 1984 (P.L. 98-397), a qualified retirement plan was required to provide automatic survivor benefits in the form of either a qualified joint and survivor annuity or a preretirement survivor annuity. Thereafter, the Tax Reform Act of 1986 (P.L. 99-514) repealed the estate tax exclusion for certain interests in qualified plans owned by a nonparticipating spouse that were attributable to community property laws. As a result, the transfer tax treatment of a nonparticipating spouse's interest in an annuity attributable to community property laws was unclear under prior law where the nonparticipating spouse predeceased the participating spouse.

Applicable exclusion amount.—In community property states, a nonparticipant spouse may be treated as having a vested community property interest in his or her participating spouse's qualified plan, individual retirement arrangement (IRA), or simplified employee pension (SEP) plan. Code Sec. 2056(b)(7)(C) clarifies that a nonparticipant spouse's survivorship interest in a participant spouse's qualified plan, IRA, or SEP that is attributable to community property laws may

qualify for qualified terminable interest property (QTIP) treatment if the nonparticipant spouse predeceases the participant spouse.

Caution. The House Committee Report notes that this provision is not intended to create an inference regarding the treatment under present law of a transfer to a surviving spouse of the decedent spouse's community property interest in an annuity. The IRS has not yet issued regulations regarding how the requirement that a qualifying income interest must relate to a specific portion of QTIP property is to be applied to annuities of decedent's dying after October 24, 1992.

Effective date. This provision is effective for the estates of decedents dying after August 5, 1997.

Act Sec. 1311(a), amending Code Sec. 2056(b)(7)(C). Law at ¶ 5435. Committee Report at ¶ 12,665.

Waiver of Right of Recovery of Estate Tax

¶ 243

Background

Under prior law, it was possible for a surviving spouse's estate to inadvertently waive its right to recover from the person receiving qualified terminable interest property (QTIP) any estate tax attributable to inclusion of the property in the surviving spouse's estate. This could happen by the use of certain testamentary language, such as a will provision specifying that all taxes shall be borne by the estate. In addition, the right of a decedent's estate to receive contribution for previously transferred property over which the decedent retained enjoyment or the right to income during life may have been waived by failure to include a specific reference to Code Sec. 2207B in a will or trust document.

Waiver must be specific.—The right of a surviving spouse's estate to recover any estate tax attributable to inclusion of qualified terminable interest property (QTIP) in the surviving spouse's estate from the person receiving the property will no longer be waived by a will provision specifying that all taxes shall be borne by the estate. In order to be effective, such a waiver must specifically refer to QTIP, the QTIP trust, Code Sec. 2044, or Code Sec. 2207A. Similarly, the right of a decedent's estate to receive contribution for previously transferred property over which the decedent retained enjoyment or the right to income during life is waived by a specific indication in a will or trust document. However, a specific reference to Code Sec. 2207B is no longer required.

Effective date. The provisions are effective with respect to estates of decedents dying after August 5, 1997.

Act Sec. 1302(a), amending Code Sec. 2207A(a)(2); Act Sec. 1302(b), amending Code Sec. 2207B(a)(2). Law at ¶ 5445 and 5447. Committee Report at ¶ 12,620.

GENERATION-SKIPPING TRANSFER TAX

Deceased Parent Exception

¶ 249

Background

Generally, a transfer to a beneficiary at least two generations below that of the transferor is a generation-skipping transfer (GST) and is subject to the GST tax. Therefore, a transfer to a grandchild or persons assigned to a grandchild's generation or younger (a "skip person") is subject to the GST tax. Such a transfer is taxable if made outright, in trust, or in an arrangement similar to a trust.

In determining whether a transfer is a direct skip for purposes of the GST tax, a grandchild of the transferor, whose parent (the child of the transferor) is deceased, will be treated as if he or she were a child of the transferor. In other words, the grandchild, and all succeeding lineal descendants of the grandchild, are moved up a generation (Code Sec. 2612(c)(2)). For transfers occurring prior to January 1, 1998, the exception does not apply to taxable terminations or distributions in trust or to transfers to collateral heirs such as grandnieces or grandnephews.

Exception to GST tax for transfers to individuals with deceased parents.—The predeceased parent exception to the generation-skipping transfer (GST) tax is expanded to include collateral heirs, provided the transferor had no living lineal descendants at the time of the transfer. The exception is also extended to taxable terminations and distributions.

> **Example (1).** Andrew Turner, who has no living lineal descendants, transfers property to his grandniece Ellen. Ellen's father (Andrew's nephew) is deceased at the time of this transfer. The transfer is not subject to the GST tax.

> **Example (2).** Elizabeth Owen transfers property to a charitable lead annuity trust for a 10-year term, with the remainder going to Owen's grandson Todd. Todd's father (Elizabeth's son) is deceased at the time the trust was created and the transfer to the trust was subject to gift tax. The termination of the 10-year term would not be a taxable termination subject to the GST tax.

Effective date. The provisions are effective for terminations, distributions, and transfers occurring after December 31, 1997.

Act Sec. 511(a), redesignating Code Sec. 2651(e) as Code Sec. 2651(f) and adding new Code Sec. 2651(e); Act Sec. 511(b), striking Code Sec. 2612(c)(2) and amending and redesignating Code Sec. 2612(c)(3) as Code Sec. 2612(c)(2). Law at ¶ 5459 and 5463. Committee Report at ¶ 10,425.

GIFT TAX

Gift Tax Filing for Gifts to Charity

¶ 253

Background

Under prior law, a gift tax return was required to be filed for any gift to a single donee in excess of $10,000 per year regardless of whether the gift qualified for a gift tax charitable deduction.

Filing requirement eliminated.—A donor who makes a gift to charity in excess of the annual gift tax exclusion is not required to file a gift tax return if the *entire* value of the donated property qualifies for a gift tax charitable deduction. This treatment extends to contributions of qualified conservation easements under Code Sec. 2522(d).

Caution. The elimination of the gift tax return filing requirement does not apply to gifts of partial interests.

Effective date. The provision is effective for gifts made after August 5, 1997.

Act Sec. 1301, adding new Code Sec. 6019(3). Law at ¶ 5579. Committee Report at ¶ 12,615.

Revaluation of Gifts for Estate Tax Purposes

¶ 255

Background

Gifts made during life, in excess of the annual gift tax exclusion and not otherwise protected by the applicable marital or charitable deduction are subject to gift tax. A person's lifetime taxable gifts are also a taken into account when computing the federal estate tax. Prior to the Taxpayer Relief Act of 1997, it was possible for the IRS to successfully argue that a decedent's lifetime taxable gifts be revalued in computing adjusted taxable gifts for estate tax purposes, even if the gift tax statute of limitations had expired and the gift had been adequately disclosed. This discrepancy created administrative and recordkeeping problems for estate administrators and fiduciaries.

Gifts may not be revalued for estate tax purposes after statute of limitations has run.—In computing adjusted taxable gifts for estate tax purposes, the IRS may not revalue gifts made during life if the gift tax statute of limitations has expired. However, in order for this provision to apply, the gift in question must have been adequately disclosed. Accordingly, the gift tax statute of limitations will not run with respect to a gift that is not adequately disclosed even if a gift tax return was filed for other transfers in the same year.

In addition, if the IRS issues a final notice of redetermination of value within the gift tax statute of limitations period, the affected taxpayer may challenge the IRS by filing a motion for declaratory judgment with the Tax Court within 90 days of the date the final notice was mailed. The statute of limitations will be tolled during the pendency of the declaratory judgment proceeding. According to the

House Committee Report, it is expected that the IRS will also develop an administrative process to allow taxpayers to challenge a redetermination of value prior to the issuance of a final notice.

PRACTICAL ANALYSIS. Sandy Schlesinger of Kaye, Scholer, Fierman, Hays & Handler, LLP, New York, points out that this provision would reverse the IRS's rulings (Rev. Rul. 84-11, 1984-1 C.B. 201; Technical Advice Memorandum 9718004) to the effect that the IRS has the ability to revalue gifts made during life for purposes of calculating the estate tax due at death. Given this change, taxpayers will be able to be certain that valuations claimed on gift tax returns which are no longer subject to the assessment of tax will not be increased by the IRS on an estate tax audit for purposes of calculating adjusted taxable gifts. This will serve to avoid subjecting an estate to higher estate tax rates. The statute is clear that the value of the gift must have been shown on a gift tax return or disclosed thereon or in a statement attached to the return or in a manner adequate to apprise as to the nature of the gift. In such a case, the value of the gift which is so disclosed may not be redetermined after the expiration of the statute of limitations period. Accordingly, a clear statement of value of an asset should be shown on a gift tax return. It should also be noted that the statutory change is effective only for gifts made after August 5, 1997.

Effective date. The provisions pertaining to revaluation of gifts and declaratory judgments are effective with respect to gifts made after August 5, 1997. The provision requiring adequate disclosure before the statute of limitations begins to run is effective with respect to gifts made in calendar years ending after August 5, 1997.

Act Sec. 506(a), adding Code Sec. 2001(f); Act Sec. 506(b), amending Code Sec. 6501(c)(9); Act Sec. 506(c), adding Code Sec. 7477; Act Sec. 506(d), amending Code Sec. 2504(c). Law at ¶ 5417, 5453, 5675, and 5729. Committee Report at ¶ 10,395.

INCOME TAXATION OF ESTATES AND BENEFICIARIES

Revocable Trusts

¶ 261

Background

Revocable trusts are often used as estate planning devices for reasons that include the avoidance of probate, privacy concerns, or the management of assets in case of incapacity. Prior to the Taxpayer Relief Act of 1997, revocable trusts were not accorded equal treatment with a decedent's estate for federal income tax purposes under several provisions of the Internal Revenue Code. This dichotomy served to discourage the use of revocable trusts in certain circumstances.

Revocable trusts to be treated as part of estate.—An election is provided to treat a qualified revocable trust as part of a decedent's estate for federal income tax purposes. The election is effective for two years from the date of the decedent's

death, if no federal estate tax return is required to be filed, or, six months after the final determination of estate tax liability, in a case in which a federal estate tax return is required. The election is irrevocable and must be made by *both* the trustee of the revocable trust and the executor of the decedent's estate, if any, by the due date for filing the estate's income tax return for its first tax year (including extensions). In addition, to provide comparable treatment under the generation-skipping transfer (GST) tax, the definition of a trust for GST tax purposes is modified.

> **Example.** The trustee of Alice Howe's revocable trust and the executor of her estate make a timely election to treat Howe's revocable trust as part of her estate for income tax purposes pursuant to new Code Sec. 646. Accordingly, the revocable trust is accorded certain income tax treatment that previously would have been available only to a decedent's estate. For example, (1) the trust would be entitled to a charitable deduction for any amount permanently set aside for charity without the requirement that such amount actually be paid first (Code Sec. 642(c)); (2) the active participation requirement under the passive loss rules is waived for two years after Howe's death pursuant to Code Sec. 469(i)(4); and (3) the trust can qualify for amortization or reforestation expenditures under Code Sec. 194(b)(4).

Caution. In order to be a qualified revocable trust the trust must be one that was treated as owned by the decedent as a result of a power held by him or her. A trust treated as owned by the decedent solely because of a power held by a nonadverse party would not qualify.

Effective date. These provisions are effective with respect to estates of decedents dying after August 5, 1997.

Act Sec. 1305(a), adding Code Sec. 646. Act Sec. 1305(b), amending Code Sec. 2652(b)(1). Law at ¶ 5199 and 5465. Committee Report at ¶ 12,635.

Distributions from Estates

¶ 264

Background

For tax years beginning on or before the date of enactment of the Tax Relief Act of 1997 (August 5, 1997), a decedent's estate was restricted in the treatment of distributions to beneficiaries made after the close of its tax year. On the other hand, a trust was able to treat such distributions made within 65 days after the close of its tax year as if they were made on the last day of the tax year. Because both trusts and estates are used as conduit devices, this difference in income tax treatment was considered unwarranted.

Sixty-five-day rule applicable to estates.—A decedent's estate may elect to treat distributions made within 65 days after the close of its tax year as if they were made on the last day of the tax year. Thus, the same income tax rule applicable to trusts is now applicable to estates.

Effective date. The provision is effective with respect to tax years beginning after August 5, 1997.

Act Sec. 1306, amending Code Sec. 663(b). Law at ¶ 5201. Committee Report at ¶ 12,640.

Separate Share Rule

¶ 267

Background

Prior to the Taxpayer Relief Act of 1997, a decedent's estate could not be divided into separate shares for income tax purposes, even if separate economic interests were created in one beneficiary or class of beneficiaries that were not affected by the economic interests accruing to other beneficiaries or classes of beneficiaries.

Separate share rule applicable to estates.—If, under a decedent's will and applicable state law, separate economic interests are created in one beneficiary or class of beneficiaries that are not affected by economic interests accruing to other beneficiaries or classes of beneficiaries, the separate share rule will apply to the decedent's estate.

> **Example.** Under the will of Ted Toyner and applicable state law, all of the shares of Toyner Enterprises, a closely held corporation, are to go to Ted's daughter, Emily. In addition, all of the dividends paid to the estate from the Toyner Enterprises stock are to be paid only to Emily and the payment of these dividends does not affect any other amounts that Emily is entitled to receive under the will. The separate share rule would apply in this instance.

Caution. According to the House Committee Report, application of the separate share rule to an estate is not elective. As in the case of a trust, such treatment is mandatory if separate shares exist.

Effective date. The provision is effective with respect to estates of decedents dying after August 5, 1997.

Act Sec. 1307, amending Code Sec. 663(c). Law at ¶ 5201. Committee Report at ¶ 12,645.

Definition of Related Persons

¶ 270

Background

Before the date of enactment of the Taxpayer Relief Act of 1997, neither Code Sec. 267 nor Code Sec. 1239 treated an executor of an estate and the beneficiary of the estate as related persons. As a result, the Code Sec. 267 provision that disallows an income tax deduction for any loss on the sale of an asset to a person related to the taxpayer did not apply to the sale of property between an executor of an estate and a beneficiary of the estate. Similarly, although the Code Sec. 1239 disallowance of capital gains treatment on the sale of depreciable property to a related person applies to a sale between a trust and the beneficiary of the trust, the provision did not apply to the sale of property between the executor of an estate and a beneficiary of the estate.

Estate and beneficiary.—An estate and a beneficiary of an estate are treated as related persons for purposes of the disallowance of a loss on the sale of an asset to a related person under Code Sec. 267 and the disallowance of capital gain treatment on the sale of depreciable property to a related person under Code Sec.

1239. This rule does not apply, however, in the case of a sale or exchange in satisfaction of a pecuniary bequest.

Effective date. The definition of related persons is effective for tax years beginning after August 5, 1997.

Act Sec. 1308(a), amending Code Sec. 267(b); Act Sec. 1308(b) adding new Code Sec. 1239(b)(3). Law at ¶ 5101 and 5349. Committee Report at ¶ 12,650.

Consistency Requirement for Beneficiaries

¶ 273

Background

Fiduciaries of domestic trusts and estates are required to furnish beneficiaries with certain information shown on the trust or estate tax return, generally via a Form 1041, Schedule K-1. In addition, a person who is treated as the owner of any portion of a foreign trust is required to ensure that the trust files a return and furnishes certain required information to each U.S. person who is treated as an owner of a portion of the trust, or who receives a distribution from the trust. However, unlike S corporation shareholders or partners, under prior law, trust and estate beneficiaries were not under a duty to file their returns in a manner consistent with the information received from the trust or estate.

Beneficiaries of trusts and estates subject to consistency reporting requirements.—Beneficiaries of an estate or trust must file their returns in a manner consistent with the manner reported on the trust or estate's return or must file a notice of inconsistent treatment with the Secretary of the Treasury that identifies the inconsistent items. Generally, a beneficiary who files a return in accordance with the information received from the estate or trust can elect to be treated as having complied with this consistency requirement. It appears that a beneficiary is also required to file a notice of inconsistent treatment when the entity does not file a return; however, the new law does not indicate what information to include in such a notice.

Caution. If a beneficiary fails to comply with these consistency requirements, any adjustment necessary in order to make the treatment of the items by the beneficiary consistent with the treatment of the items on the entity's return will be treated as a mathematical or clerical error that is subject to summary assessment procedures. Also, the negligence penalty may apply.

Foreign trusts. The return of a U.S. person who is treated as the owner of a foreign trust must be consistent with the information reported by the trust.

Effective date. These consistency requirements apply to returns of beneficiaries and owners filed after August 5, 1997.

Act Sec. 1027(a), adding Code Sec. 6034A(c); Act Sec. 1027(b), adding Code Sec. 6048(d)(5). Law at ¶ 5585 and 5605. Committee Report at ¶ 11,245.

TRUSTS

Throwback Rules for Domestic Trusts

¶ 275

Background

Income that is accumulated in a nongrantor trust is taxed at the trust's separate rate schedule. Although, at one time, it was possible to use multiple trusts to successfully shift income from the trusts' beneficiaries to the trusts, this practice was curtailed by the Deficit Reduction Act of 1984 (P.L. 98-369). Similarly, relatively compressed tax rates currently applicable to income accumulated in a trust make income shifting techniques less attractive than they once were. However, prior to the Taxpayer Relief Act of 1997, the so-called throwback rules still required that distributions that were previously accumulated and taxed in a trust be included in a trust beneficiary's income if the beneficiary's top average marginal tax rate during the previous five years was higher than that of the trust. In addition, a separate rule required that any gain on the sale of appreciated property contributed to a trust that was sold within two years of its contribution being taxed at the contributor's marginal tax rates.

Throwback rules repealed.—The throwback rules no longer apply to domestic trusts. The rules required that distributions that were previously accumulated in a trust be included in a trust beneficiary's income if the beneficiary's top average marginal tax rate in the previous five years was higher than that of the trust. In addition, the rule that required that any gain on the sale of appreciated property contributed to a trust be taxed at the contributor's marginal tax rates if the property were sold within two years of its contribution is repealed.

Planning Note. The compressed tax rates currently applicable to income accumulated in a trust (for 1997, the 39.6-percent rate applies to taxable income in excess of $8,100) discourage strategies that attempt to use trusts as a means of shifting income away from the trust's beneficiaries. Having otherwise negated these tax avoidance techniques, elimination of the throwback rules and the rule on trusts selling appreciated assets should simplify trust tax preparation.

Caution. The repeal of the throwback rules does not apply to trusts created before March 1, 1984, that would be treated as multiple trusts under Code Sec. 643(f). Nor does the repeal apply to foreign trusts or to domestic trusts that were once treated as foreign trusts (except as provided in regulations).

Effective date. The provision repealing the throwback rules is effective with respect to distributions made in tax years beginning after August 5, 1997. The provision eliminating the rule on the sale of appreciated property contributed to a trust is effective with respect to sales or exchanges occurring after August 5, 1997.

Act Sec. 507(a), amending Code Sec. 665(b) and adding Code Sec. 665(c); Act Sec. 507(b), striking Code Sec. 644, redesignating Code Sec. 645 as Code Sec. 644, and amending Code Sec. 706(b)(5). Law at ¶ 5195, 5196, 5197, 5205 and 5219. Committee Report at ¶ 10,415.

Charitable Remainder Trusts

¶ 281

Background

In general, no charitable deduction is allowed when a donor transfers property to charity while retaining an interest in that property (e.g., an income interest) or transferring an interest in that property for less than full and adequate consideration. An important exception to this rule is made for charitable remainder trusts.

There are two kinds of charitable remainder trusts, a charitable remainder annuity trust (CRAT) and a charitable remainder unitrust (CRUT). A CRAT is a trust that is required to pay, at least annually, a fixed dollar amount equal to at least five percent of the initial value of the trust assets to a noncharitable beneficiary for the life of an individual or for a term of years (not to exceed 20 years). A CRUT is similar except that the amount of the annual payments is a fixed percentage of the trust assets, valued annually.

The character of distributions from a charitable remainder trust is determined according to the following ordering rule:

(1) as ordinary income to the extent of the trust's current and previously undistributed ordinary income for the trust year in which the distribution occurred;

(2) as capital gain to the extent of the capital gain of the trust for the year and the undistributed capital gain of the trust for prior years;

(3) as other income (e.g., tax-exempt income) to the extent of such income of the trust for the year and such undistributed income of the trust for prior years; and

(4) as a distribution of trust corpus.

Distributions are includible in the income of the beneficiary for the year that the annuity or unitrust payment is required to be distributed, even though the annuity or unitrust payment is not made until the end of the trust's tax year.

Under prior law, a literal reading of these provisions led to accelerated charitable remainder trusts being used to convert appreciated assets into cash while avoiding most of the tax on the appreciation. For example, some taxpayers created CRUTs with an annual payout rate of 80 percent and funded them with highly appreciated assets that produce no income. In addition, the trust would make no distribution in Year 1, but would sell all the trust assets at the beginning of Year 2. The proceeds from this sale would then be used to pay the required distribution for the previous year. These taxpayers treated this distribution of 80 percent of the trust assets as a nontaxable distribution of trust corpus under the ordering rule because the trust did not realize any income during its first year.

> **Example.** May Dodge transfers assets with a fair market value of $1,000,000 and a basis of $0 to a charitable remainder unitrust (CRUT) on January 1, 1995. The assets pay no income, and the trust term is two years. The annual unitrust payout is set at 80 percent of the fair market value of the trust assets valued annually.
>
> The required payout for 1995 is $800,000 (.8 × $1,000,000). However, no actual payment is made to Dodge during 1995. At the beginning of 1996, all the assets are sold for $1,000,000 and the 1995 unitrust payout amount

Background

($800,000) is distributed to Dodge on January 2, 1996. In 1996, the unitrust payout amount is $160,000 (.8 × the $200,000 remaining in the trust). At the end of 1996, the trust terminates and $40,000 is paid to a qualified charitable organization.

Proponents of the technique argued that the transaction should receive extremely favorable tax treatment under the ordering rules of Code Sec. 664(b). Under this interpretation, distributions are includible in the recipient's income for the year that the payment is required to be made even though the distribution is not made until the following year. As a result, the $800,000 distribution on January 2, 1996 is treated as a nontaxable distribution of corpus because the trust had no ordinary income, capital gain or other income in 1995.

The $160,000 unitrust payout for 1996 would be characterized as capital gain. The tax on this amount would be $44,800 (.28 × $160,000). This would leave the donor with $915,200, $800,000 from 1995 and $115,200 ($160,000 − $44,800) from 1996. Note that if Dodge had sold the property instead, she would have paid tax of $280,000 on the $1,000,000 capital gain, leaving $720,000. By using the high-payout CRUT, the donor is left with $195,200 more ($915,200 − $720,000).

On April 18, 1997, the IRS proposed regulations under Code Secs. 664 and 2702 to address the type of abuse described above and other perceived abuses involving charitable remainder trusts. The regulations included a rule that would require that payment of any required annuity or unitrust amount by a charitable remainder trust be made by the close of the year in which the payment is due.

Prior to the Taxpayer Relief Act of 1997, the minimum annual payout percentage for a charitable remainder trust was five percent, however, there was no maximum payout percentage. In addition, there was no minimum actuarial value for the remainder interest.

New payout and value of remainder interest requirements.— The Taxpayer Relief Act of 1997 imposes new restrictions on charitable remainder trusts. The Act requires that a charitable remainder trust cannot have a maximum payout percentage in excess of 50 percent of the trust's fair market value. In addition, the Act requires that the value of the charitable remainder be at least 10 percent of the net fair market value of property transferred in trust on the date of contribution to the trust.

Percentage payout limitation. A trust will not qualify as a charitable remainder trust if the annual payout exceeds 50 percent. In the case of a charitable remainder annuity trust (CRAT), this means that the annual payout cannot exceed 50 percent of the initial fair market value of the trust's assets. In the case of a charitable remainder unitrust (CRUT), it means that the annual payout cannot exceed 50 percent of the fair market value of the trust assets determined annually. According to the Senate Committee Report, trusts failing this 50-percent test will be treated as complex trusts rather than charitable remainder trusts, and, as a result, all of their income will be taxed to the beneficiaries of the trust.

Minimum charitable benefit. A new 10-percent minimum value requirement is also imposed on charitable remainder trusts. In the case of a CRAT, the value of the remainder interest must be at least 10-percent of the initial fair market value

of all property placed in the trust. In the case of a CRUT, the 10 percent minimum applies with respect to each contribution of property to the trust (note that additional deductible gifts may be made to a CRUT under Reg. § 1.664-3(b)). There are several special provisions designed to provide relief for trusts that do not meet the 10-percent test.

Voiding or reformation of trust. A trust that would qualify as a charitable remainder trust but for failure to meet the minimum value test may be declared void *ab initio* or reformed to bring the value of the remainder interest up to, or above, the 10-percent requirement. If the trust is declared void *ab initio,* no income tax deduction would be allowed for any transfer to the trust, and any transaction entered into by the trust before it was declared void is treated as entered into by the transferor. For example, income earned on the assets transferred to the trust and capital gains generated by sales of the property transferred would be income and capital gain of the donor, and the donor would not be permitted a charitable deduction with respect to the transfer. The Conference Committee Report states that the statute of limitations applicable to a deficiency of any tax resulting from reformation of the trust will not expire until the date that is one year after the IRS is notified that the trust has been revoked.

The value of the remainder interest can be increased so that it satisfies the 10-percent test by either reducing the payout percentage or shortening the term (or both).

> **Example.** Bob Smith (age 60) transfers $1,000,000 to a CRAT, while retaining an 11 percent annuity for 15 years. The applicable Code Sec. 7520 rate is 8 percent. Under this scenario, the actuarial value of the remainder interest is $58,455. Because this is only 5.8 percent of the initial fair market value of the trust assets, the CRAT would fail the 10-percent test. If the payout percentage is reduced to 10 percent ($100,000 per year), however, the value of the remainder interest increases to $144,050, enabling the trust to pass the test. The trust term could also be decreased to allow the trust to satisfy the 10-percent test. For instance, if the trust term was reduced to 10 years, the value of the remainder interest would increase to $261,889.

A reformation made to allow the trust to satisfy the 10 percent test would have to be commenced within the period specified in Code Sec. 2055(e)(3)(C)(iii). Thus, the reformation would have to be made no later than the 90th day after the last date (including extensions) for filing the estate tax return, or if no estate tax return was required to be filed, the last date (including extensions) for filing the income tax return for the first tax year for which such return is required to be filed by the trust. The Conference Committee Report states that the statute of limitations applicable to a deficiency of any tax resulting from reformation of the trust will not expire before the date one year after the IRS is notified that the trust has been reformed.

Additional contributions to a unitrust. If an additional contribution is made to a trust that, before the contribution was a charitable remainder unitrust, and the contribution would have the effect of causing the trust to violate the 10-percent rule, such contribution will be treated as a transfer to a separate trust under regulations to be prescribed by the Secretary. As a result, such transfer does not affect the status of the original trust as a charitable remainder unitrust.

Effective date. The 50-percent maximum payout limitation applies to transfers in trust after June 18, 1997. The 10-percent limitation on the minimum value of the remainder interest generally applies to transfers in trust after July 28, 1997.

Under a special rule, however, the 10 percent rule will not apply to transfers in trust under the terms of a will or other testamentary instrument executed on or before July 28, 1997, if the decedent (1) dies before January 1, 1999 without having republished the will or amending it by codicil or otherwise or (2) was, on July 28, 1997, under a mental disability to change the disposition of the property and did not regain competency before dying.

Act Sec. 1089(a), amending Code Secs. 664(d)(1)(A) and (2)(A); Act Sec. 1089(b), adding Code Secs. 664(d)(1)(D) and (2)(D), and 2055(e)(3)(J) and amending Code Sec. 2055(e)(3)(G). Law at ¶ 5203 and 5433. Committee Report at ¶ 11,555.

¶ 284

Background

An employee stock ownership plan (ESOP) is a defined contribution plan in the form of a qualified stock bonus plan or a combination stock bonus and money purchase pension plan that is designed to invest primarily in qualifying employer securities for the benefit of employees.

A federal estate tax charitable deduction is allowed for the value of property transfers by a decedent for public, scientific, literary, educational, charitable, or religious purposes. The property for which the deduction is taken must be includible in the decedent's gross estate. If property is transferred for both charitable and noncharitable purposes in a charitable remainder trust, the trust must satisfy the requirements for a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT). A CRAT is a trust from which a sum certain or a specified amount, but not less than five percent, of the initial fair market value of the property placed in the trust is paid to the income beneficiary or beneficiaries at least annually. A CRUT is a trust that specifies that the income beneficiary or beneficiaries are to receive annual payments of a fixed percentage, but not less than five percent, of the net fair market value of the trust's assets, valued annually. A CRAT and a CRUT cannot have a noncharitable remainder beneficiary if a deduction is to result. Under prior law, a transfer of a remainder interest in property to an ESOP did not qualify for an estate tax charitable deduction.

Transfers by charitable remainder trusts to ESOPs.—In order to encourage certain transfers of stock to employee stock option plans (ESOPs), a charitable remainder trust may make certain limited transfers of qualified employee securities to an ESOP without adversely affecting the status of the charitable remainder trust under Code Sec. 664. Therefore, a qualified gratuitous transfer of employer securities to an ESOP is deductible from a decedent's gross estate under Code Sec. 2055 to the extent of the present value of the remainder interest in a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT).

Qualified gratuitous transfers. A transfer of qualified employee securities to an ESOP is a "qualified gratuitous transfer" if the following requirements are satisfied:

(1) the securities transferred previously passed to a CRAT or a CRUT from a decedent dying before January 1, 1999;

(2) the decedent and members of his or her family owned no more than 10 percent of the value of the outstanding stock of the company, directly or indirectly, at the time of the transfer to the ESOP;

(3) the ESOP owns at least 60 percent of the value of outstanding stock of the company immediately after the transfer to the ESOP;

(4) the ESOP was in existence on August 1, 1996;

(5) the employer consents to the application of the excise tax imposed by Code Sec. 4978 upon certain dispositions of securities by ESOPs and by Code Sec. 4979A upon certain prohibited allocations of qualified securities;

(6) no deduction under Code Sec. 404 is allowable with respect to the transfer; and

(7) the ESOP meets the requirements discussed below.

Plan requirements. In order for a transfer to qualify as a gratuitous transfer, the ESOP must not discriminate in favor of highly paid employees and must provide:

(1) that the plan participants are entitled to direct the manner in which securities transferred and allocated to such participants are to be voted;

(2) for an independent trustee (i.e., a trustee that is not a five-percent owner of the company or a family member of the decedent) to vote securities transferred that are not allocated to plan participants;

(3) that participants have the right to receive distributions in the form of stock and that the participants can require the employer to repurchase any shares distributed under a fair valuation formula (i.e., a formula that does not take into account a discount for minority interests); and

(4) that if the plan is terminated before all the transferred stock has been allocated, the remaining stock is to be transferred to one or more charitable organizations.

Qualified employer securities. "Qualified employer securities" means employer securities, as defined by Code Sec. 409(l), which are issued by a domestic corporation (1) that has no outstanding stock that is readily tradable on an established securities market and (2) that has only one class of stock.

Treatment of transferred securities and allocation rules. The ESOP must treat the transferred securities as employer securities, except for purposes of determining the amount of deductible contributions to the plan otherwise permitted by the employee. In addition, the ESOP is required to allocate the transferred securities up to the Code Sec. 415 limit on contributions and benefits after allocating any other employer contributions for the year. Any of the transferred securities that can not be allocated because of the Code Sec. 415 limits must be held in a suspense account and allocated in the same manner in subsequent years.

If any of the securities transferred to an ESOP by a CRAT or CRUT are allocated to the account of (1) any person related to the decedent or members of the decedent's family or (2) any employee owning more than five percent of any class of outstanding stock of the corporation issuing the securities or the total value of any class of outstanding stock of such corporation, the ESOP shall be treated as having distributed to such person or shareholder the amount so allocated. A person is treated as related to the decedent within the meaning of Code Sec. 267(b). Family members are persons related to the decedent within the meaning of Code Sec. 2032A(e)(2).

If unallocated securities are not transferred to a Code Sec. 170(c) charitable organization as required, a tax is imposed on the employer maintaining the plan

equal to the sum of (1) the amount of the increase in estate tax that would have occurred if such securities had not been transferred to the ESOP and (2) interest on such amount at the underpayment rate from the due date for filing the estate tax return.

Effective date. These amendments are effective for transfers made by trusts to, or for the use of, an employee stock ownership plan after August 5, 1997.

Act Sec. 1530(a), amending Code Sec. 664(d); Act Sec. 1530(b), adding new Code Sec. 664(g); and Act Sec. 1530(c), amending Code Secs. 401(a)(1), 404(a)(9), 415(c)(6), 415(e), 664(d), 674(b)(4), 2055(a), 2056(b)(8), 4947(b), 4975(e)(7), 4978(a), 4978(b)(2), 4978(c), 4978(e)(2), and 4979A(a) and (c), redesignating Code Sec. 4979A(d) as (e) and adding new Code Sec. 4979A(d). Law at ¶ 5131, 5137, 5153, 5203, 5207, 5433, 5435, 5521, 5529, 5531 and 5533. Committee Report at ¶ 13,435.

Pre-need Funeral Trusts

¶ 286

Background

A funeral trust is an arrangement whereby an individual purchases funeral services or merchandise from a funeral home prior to his or her death. The payment amount is held in trust and paid to the seller upon the individual's death. Under prior law, a pre-need funeral trust was generally treated as a grantor trust and the annual income earned by the trust was taxed to the purchaser/grantor of the trustee.

Taxation of earnings of pre-need funeral trusts.—If a trustee elects special tax treatment, a pre-need qualified funeral trust is not treated as a grantor trust and the tax on the annual earnings of the trust is payable by the trustee. If the election is made, the Code Sec. 1(e) income tax rate schedule generally applicable to estates and trusts is applied to the trust by treating each beneficiary's interest as a separate trust. However, the trust is not entitled to a Code Sec. 642(b) personal exemption in calculating the tax. The trustee's election must be made separately for each purchaser's trust. No gain or loss is recognized to a purchaser of a pre-need funeral trust contract as a result of any payment from the trust to the purchaser due to the cancellation of the contract.

Qualified funeral trust. A trust is a qualified funeral trust if it meets the following requirements:

(1) the trust arises as the result of a contract with a person engaged in the trade or business of providing funeral or burial services or property necessary to provide such services;

(2) the sole purpose of the trust is to hold, invest, and reinvest the trust funds and to use the funds solely to make payments for such services or property for the beneficiaries of the trust;

(3) the only beneficiaries of the trust are the individuals with respect to whom such services or property are to be provided at their death under the contract;

(4) the only contributions to the trust are contributions by or for the benefit of the trust's beneficiaries; and

(5) the trust has not accepted aggregate contributions by or for the benefit of any individual in excess of $7,000. The $7,000 limit is indexed for inflation for contracts entered into after 1998.

These provisions apply to contracts purchased by one individual to have funeral and burial services or merchandise provided for another individual upon that individual's death, to the extent that such trust would otherwise be treated as a grantor trust.

For purposes of the funding limitation, all trusts having trustees that are related persons are treated as one trust.

Effective date. The special treatment of funeral trusts is effective for tax years ending after August 5, 1997.

Act Sec. 1309, adding new Code Sec. 685. Law at ¶ 5213. Committee Report at ¶ 12,655.

Chapter 3

Business and Investment

CAPITAL GAINS AND LOSSES

Individual Capital Gains Rate

¶ 301

Background

Under prior law, the maximum tax rate on an individual's net long-term capital gain was 28 percent. If the individual's maximum tax rate was less than 28 percent (e.g., 15 percent), then this lower tax rate would be applied to the individual's net long-term capital gain. In addition, prior law provided that if the individual held the property more than 12 months, any gain or loss from the sale or exchange would be treated as long-term.

Revised holding periods and tax rates for long-term capital gains.—The holding periods for long-term capital assets have generally been increased and the tax rates for long-term capital gains have been reduced. The exact holding period to be applied and the tax rate to be used depends upon when the asset was sold or exchanged. The new holding periods are discussed at ¶ 302 and the new tax rates are discussed at ¶ 303.

Effective date. This provision applies to tax years ending after May 6, 1997.

Act Sec. 311(a), amending Code Sec. 1(h); Act Sec. 311(d). Law at ¶ 5001. Committee Report at ¶ 10,295.

Holding Period for Long-Term Capital Assets

¶ 302

New holding period for long-term capital assets.—Generally, for sales and exchanges after July 28, 1997, the long-term capital gains rates will only apply if the taxpayer holds the asset more than 18 months. Special low rates for assets held more than five years go into effect after December 31, 2000.

Planning Note. In determining how long an asset was held, the taxpayer begins counting on the date after the day the property was acquired. The same date of each following month is the beginning of a new month regardless of the number of days in the preceding month. For example, if property was acquired on February 1, 1997, the taxpayer's holding period began on February 2, 1997. The date the asset is disposed of is part of the holding period.

Holding period for capital assets sold before July 29, 1997. If an individual sold a capital asset *before* July 29, 1997, the individual must have held the asset more than 12 months in order for the long-term capital gains rates to apply.

Holding period for capital assets sold after July 28, 1997. If an individual sells a capital asset *after* July 28, 1997, the individual must have owned the asset more than 18 months in order for the long-term capital gains rate to apply.

Planning Note. A 28-percent maximum tax rate applies to assets sold after July 28, 1997, that were held more than 12 months and not more than 18 months. If the individual is in the 15-percent tax bracket, the 15-percent tax rate will apply. See ¶ 303 for a complete discussion on the new tax rates for long-term capital gains.

Holding period for assets sold after December 31, 2000. The 18-month holding period still applies for assets sold after December 31, 2000. However, if the asset was held more than five years, the individual will generally be entitled to a long-term rate that is lower than the normal long-term rate. These rules are illustrated and discussed in detail at ¶ 303.

Effective date. This provision applies to tax years ending after May 6, 1997.

Act Sec. 311(a), amending Code Sec. 1(h); Act Sec. 311(d). Law at ¶ 5001. Committee Report at ¶ 10,295.

Tax Rates for Long-Term Capital Assets

¶ 303

New tax rates for long-term capital gains.—Generally, for sales of long-term capital assets after *May 6, 1997,* the maximum capital gains rate is 20 percent (10 percent for individuals in the 15-percent tax bracket). Generally, a special lower rate of 18 percent (8 percent for individuals in a 15-percent tax bracket) applies to transactions after December 31, 2000 when the asset was held more than five years. These rules are discussed in detail in the following material.

Planning Note. The lower capital gains rate applies not only to individuals, but also to estates and trusts. In addition, the lower rate would apply when the taxpayer is determining the regular income tax, as well as the alternative minimum tax.

PRACTICAL ANALYSIS. Martin Nissenbaum, National Director of Personal Income Tax Planning for Ernst & Young LLP, New York, New York, observes that the failure to coordinate the new capital gains rules with other provisions of the Code may lead to unanticipated results for some taxpayers. For example, although the 20-percent comparable capital gains rate for alternative minimum tax (AMT) would appear to be the same as that for ordinary income tax purposes, it does not necessarily result in equal treatment in all cases. Thus, a person with $1 million in taxable long-term gains who paid $100,000 in state and local taxes attributable to those gains may end up paying 20 percent on the entire $1 million and lose the benefit of the deduction that would otherwise flow from the payment of state and local taxes. Mr. Nissenbaum suggests that taxpayers should, if possible, attempt

to postpone or accelerate payments for state and local taxes on capital gains into years when they are not subject to the AMT.

A similar problem is presented with respect to incentive stock options (ISOs). For AMT purposes, stock acquired by exercise of an ISO is treated as though it were taxable under the Code Sec. 83 rules governing taxation of property given for services rather than under the Code Sec. 421 rules that govern ISOs for regular income tax purposes. Under the Code Sec. 83 rules, the difference between the value of ISO stock and the price paid for it by the employee upon exercise is includible in AMT when the stock is freely transferable or not subject to a substantial risk of forfeiture. No AMT adjustment is necessary if the exercise of an ISO and the disposition of the stock acquired occur within the same tax year. However, the effect of the new capital gains rates on a taxpayer with ISO adjustments who is subject to the AMT is to force accelerated payment at the higher AMT rate rather than the lower rate which would apply when the stock is ultimately sold.

On the brighter side, Mr. Nissenbaum notes that in some situations the failure to coordinate changes in the capital gains rules with other Code provisions may work to a taxpayer's advantage. For example, under the new rules, appreciated property held by a taxpayer for more than 12 months, but less than 18 months, would qualify for an income tax charitable deduction based on fair market value even though gain on the sale of the property would have been taxed at the 28-percent mid-term rate rather than at the 20-percent long-term rate. This result occurs because the new law did not change the definition of long-term property for purposes of the deduction for charitable contributions provided under Code Sec. 170.

Caution. The lower rate applies only to sales or exchanges after May 6, 1997. Thus, if a taxpayer's tax year includes sales or exchanges before May 7, 1997, the taxpayer must determine net capital gain for the period prior to May 7, 1997 and for the period after May 6, 1997. The maximum capital gains rate of 28 percent applies to the net capital gains recognized before May 7, 1997.

Planning Note. Even though the lower rate applies to net capital gain for sales and exchanges after May 6, 1997, the legislative history of this provision states that the lower rate applies to *installment payments* received on or after May 7, 1997. In addition, if a taxpayer elects to treat any amount of net capital gain as investment interest (i.e., the election allowed under Code Sec. 163(d)(4)(B)(iii)), then that amount is subtracted from the total net capital gain in order to determine the amount subject to the maximum capital gains rate.

Long-term capital gains rates for assets sold after May 6, 1997. When an individual has a net long-term capital gain on an asset sold after May 6, 1997, the maximum long-term capital gains rate is 20 percent (10 percent, if the individual is in a 15-percent tax bracket).

Planning Note. Remember, when applying this new long-term rate, that the holding period for long-term assets changed effective for sales after July 28, 1997. For sales through July 28, 1997, the long-term holding period was met if the individual held the asset more than 12 months. For sales on or after July 29, 1997,

the long-term holding period was increased to more than 18 months. However, a special relief provision prevents individuals from paying tax on their gains at a rate higher than they would have if the law had not been changed. See the Examples below for illustrations of how these new rules are applied.

Example (1). On May 8, 1997, John Aubrey sold 10 shares of Gizmo Inc. for $1,000. Aubrey had purchased the shares on January 6, 1996, for $400. If Aubrey is in a 28%, 31%, 36%, or 39.6% marginal tax bracket, he will compute his tax on his $600 of long-term gain by using the long-term rate of 20%. If he is in a 15% marginal tax bracket, he will apply a long-term rate of 10%.

Example (2). Assume the same facts as in Example 1, except that Aubrey sold the shares on May 6, 1997. In this situation, he is *not* entitled to use the new long-term rate of 20% (or 10%) because he did not sell the stock after May 6, 1997. However, because he held the stock for more than 12 months, the former maximum long-term capital gains rate of 28% will be applied against his $600 gain (15% tax rate, if he is in a 15% tax bracket).

Special rates for assets sold after July 28, 1997 that were not held more than 18 months. The determination of the tax rate to be used for computing gain on the sale of assets sold after July 29, 1997, is made more complicated because the new law changed the long-term holding period for assets sold after July 28, 1997. The long-term holding period was increased from "more than 12 months" to "more than 18 months." In determining the tax rate to be applied to the individual's gain on assets sold after July 28, 1997, the following rules should be applied:

(1) If the asset was held *12 months or less,* the capital gain is treated as short-term capital gain and taxed as ordinary income.

(2) If the asset was held *more than 18 months,* the capital gain is treated as long-term capital gain and taxed at the new maximum rate of 20 percent (10 percent, if the individual is in the 15-percent bracket).

(3) If the asset was held *more than 12 months but not more than 18 months,* the gain is taxed at the former maximum long-term capital gains rate of 28 percent (15 percent if the individual is in a 15-percent tax bracket).

Example (3). On August 1, 1997, Betty Green, who is in a 39.6% marginal tax bracket, sold 100 shares of stock and recognized a net capital gain of $1,000. She had held the stock 15 months. The maximum capital gains rate of 20% *does not* apply because she sold the stock after July 28, 1997 and she did not hold it for more than 18 months. However, the gain is not taxed at her ordinary income tax rate of 39.6%. Instead, she may apply the former maximum capital gains rate of 28% in order to compute her tax. (If she was in the 15% tax bracket, her tax would be computed by using the 15% rate, not the new 10% rate.)

Planning Note. The Code refers to gain realized after July 28, 1997, from property held more than 12 months but not more than 18 months, as "mid-term gain." It is a term and concept that will play an important part in the computation of an individual's capital gains tax over the next few years.

Long-term capital gains rate for tax years beginning after December 31, 2000. In general, the new capital gains rates of 20 percent or 10 percent will continue to apply after December 31, 2000, provided the regular long-term holding period has been met (i.e., more than 18 months). However, a lower capital gains rate of 18 percent (8 percent for individuals in a 15-percent tax bracket) may be applied if the individual held the asset more than five years.

Planning Note. Another complication is added under the new law because the date that the five-year holding period starts is different for individuals in a 15-percent tax bracket than for individuals in higher brackets. The following rules should be applied in order to determine when the five year holding period begins:

(1) If the individual is in a tax bracket that is higher than 15 percent, the five-year holding period only applies to assets acquired after December 31, 2000. (However, a special election allows these individuals to treat prior acquired assets as acquired on January 1, 2001. See "Special election for capital assets acquired in tax years beginning before January 1, 2001," below.)

(2) If the individual is in a 15-percent tax bracket, the asset does not have to be acquired after December 31, 2000 in order to have the five year period begin.

These rules are illustrated in the Examples below.

Example (4). Bob Bailey is in a 39.6% tax bracket. On January 2, 2001, he purchased 10 shares of stock in Azor Inc. If he holds the stock more than five years and sells it at a gain, his net long-term capital gain will be taxed at a maximum rate of 18%. Conversely, if he holds the stock for more 18 months but not more than five years, his gain will be subject to the maximum capital gains rate of 20%.

Example (5). Jane Smith is in a 15% tax bracket. In 1998, she purchases 100 shares of stock. If she holds the stock more than five years, she may compute her capital gains tax by using the special 8% rate. Because she is in the 15% tax bracket, she did not have to acquire the stock after December 31, 2000, in order to have the five-year holding period apply. Conversely, if she holds the stock more than 18 months but not more than five years, her maximum capital gains rate will be 10%.

Planning Note. In determining when the five-year holding period begins, the Code provides that, if property was acquired under an option or other right to acquire property, the five-year period includes the period of the option.

Special election for capital assets acquired in tax years beginning before January 1, 2001. As a general rule, an individual in a marginal tax bracket higher than 15 percent must acquire an asset after December 31, 2000, in order to have the special lower capital gains rate for five-year property apply to the gain from the asset. However, these individuals may make a special election to treat pre-January 1, 2001, property as being acquired on January 1, 2001, and, thus, make the property eligible for the five-year holding period rule. In order to make the election, the individual must treat the asset as if it were sold on January 1, 2001, (or the next business day) at its fair market value. Any income tax due on the gain from this deemed sale of the asset must be paid. However, if the individual would realize a loss from this deemed sale, the loss is not recognized.

Planning Note. Individuals who want to take advantage of this election may have it apply to readily tradable stock, any other capital asset, and certain property used in the taxpayer's trade or business (i.e., business property defined in Code Sec. 1231(b)).

Example (6). Max Brand is in a 28% tax bracket. He purchases 10 shares of Binnacle Inc. in 1998 for $1,000. He still owns the shares on January 1, 2001. He plans on holding the stock for a few more years and wants to take advantage of the 18% special long-term rate when he sells the stock. He may

elect to treat the stock as if he sold it on the next business day and pay any resulting tax. Assume that the stock had a fair market value of $1,500 on January 2, 2001. Max would pay the tax on his deemed $500 gain when he filed his tax return for 2001. His five-year holding period would begin and his basis in the stock would now be $1,500.

PRACTICAL ANALYSIS. Tim Kochis, President, Kochis Fitz Tracy & Gorman, Inc., San Francisco, California, observes that the reduced tax liability on long-term capital gains is likely to have several distinct and far-reaching impacts. Just a few of these will be on individuals' investment decisions, on use of tax-deferred programs such as IRAs and qualified and nonqualified deferred compensation plans, on the design of executive compensation programs, as well as on the relative attractiveness of certain charitable contribution structures.

First, the existing preference for investments that produce returns primarily in the form of capital appreciation, instead of dividends or interest, is greatly increased. Markets could suffer a modest decline in the short term, as pent-up asset value growth in stock portfolios and residential real estate hits the market in an initial selling wave. Nevertheless, the long-term benefits of growth-oriented investments have substantially increased as the tax burden has declined—relative both to what it had been and especially relative to the tax on the alternative form of investment return. This should bode well for equity market performance for the foreseeable future and should further the trend away from distribution of corporate earnings as dividends in favor of internal reinvestment, acquisition, and/or share repurchases, thus reinforcing the capital growth preference.

Ironically, therefore, the *relative* advantage of tax-*deferred* vehicles has diminished, since now investments outside IRAs and qualified plans can yield very low tax exposure where the results of deferred investments are generally taxed at potentially much higher ordinary income tax rates. However, so long as a tax *deduction* is available at the point of entry and the deferral is at least several years, deferral can still overcome the tax disadvantage at exit.

The same cannot be said for nondeductible tax-deferred annuities or traditional nondeductible IRAs. Without a tax deduction at the outset for the contribution, the severe tax disadvantage for the distribution will be virtually impossible to overcome, especially given the higher cost structures associated with the annuity vehicles. This is not to say that annuities, particularly variable annuities, will not continue to provide advantages for some investors. If someone is *already* invested in such a vehicle, it will almost certainly remain appropriate to stay; and, for some, the insurance protection features could justify a wholly new purchase. But, in general, the popularity of these vehicles will likely wither unless there is a dramatic reduction in their internal costs and/or some major structural modification to deal with the tax albatross they now carry.

Corporate stock incentive programs are likely to resurrect their preference for incentive stock options (ISOs) over the non-qualified version because the benefit of long-term capital gains treatment is so much more advantageous to the employee. And, while the Code Sec. 83(b) election for the grant of restricted stock may now appear more attractive, if faith in the stock's eventual performance would justify the up-front tax, the better course of action will still be to avoid the election and apply the amount of the would-be tax to an *additional* purchase of the corporate stock on the open market.

Nonqualified deferred compensation plans are likely now to continue their movement toward equity-based growth measures as the general market preference for equity returns is enhanced. Still, some companies may decide to abandon these arrangements and/or employees may decline to participate—given the illiquidity and potential credit risks of these plans—now that their *relative* advantage over "outside" investment has declined.

The following diagram summarizes these very broad investment/tax generalizations:

	"Outside" of Deferred Vehicles	*Tax Deductible Deferrals*	*Non-Tax-Deductible Deferrals*
Income-Oriented Investments	POOR	OK	OK
Capital Growth-Oriented Investments	EXCELLENT	VERY GOOD	GOOD

Finally, the cost of a charitable contribution of appreciated property has gone up since the tax otherwise has gone down. This may sufficiently reduce the attractiveness of the otherwise constrained use of capital gain property to cause contributors to use cash instead. This may be the case especially in the typical charitable remainder trust situation where the threat of a large tax liability on highly appreciated property is often a major motivating factor. The now reduced tax on that appreciation may cause many contributors to choose much simpler and more direct approaches to the twin objectives of diversification and charitable largesse.

Depreciable real estate. Long-term capital gain from the sale or exchange of depreciable real property that would be treated as ordinary income if the property were depreciable personal property (i.e., Code Sec. 1245 property) is taxed at a maximum rate of 25 percent. The balance of the remaining long-term capital gain is taxed at a maximum rate of 20 percent.

Example (7). In 1998, Joe Green sold a building for $125,000. Green had originally paid $50,000 for the building a number of years ago. Over the years that he owned the building, Green had deducted $50,000 in depreciation. Thus, his basis in the building was zero at the time of sale. Of his $125,000 recognized gain, he would pay a maximum rate of 25% on $50,000 (i.e., the amount that had been allowable as depreciation) and a maximum rate of 20% on the remaining $75,000.

Pass-through entities. A pass-through entity (e.g., mutual funds, S corporations, partnerships, estates and trusts) may pass through capital gains to their

shareholders or beneficiaries. The pass-through entity must make the determination of when a long-term capital gain is taken into account on its books. Therefore, a gain taken into account by a pass-through entity before May 7, 1997, is *not* eligible for the new lower capital gains rate.

Collectibles. As a general rule, collectibles do *not* qualify for the new lower rates. For example, stamps, antiques, gems, and most coins would still be taxed at the maximum rate of 28 percent.

Planning Note. Certain newly minted gold and silver coins issued by the federal government and coins issued under state law are subject to the lower capital gains rate, even though such coins generally qualify as "collectibles."

Small business stock. When a taxpayer sells or exchanges certain small business stock (i.e., Sec. 1202 stock) that the taxpayer has held for more than five years, 50 percent of the gain may be excluded from the taxpayer's gross income. If the small business stock qualifies for this 50-percent exclusion, any recognized gain from the sale or exchange of the stock may not be taxed at the lower capital gains rate.

Planning Note. This provision prevents the taxpayer from reaping a double benefit from the stock (i.e., 50-percent exclusion and the maximum capital gains rate of 20 percent). However, if such stock was sold or exchanged before it was owned five years by the taxpayer, the gain would still be subject to the 20-percent maximum capital gains tax rate.

Tax preference item for small business stock. Under prior law, 50 percent of the exclusion of gain from small business stock was treated as a tax preference item for purposes of calculating the taxpayer's alternative minimum tax liability. The new provision reduces this tax preference item to 42 percent of the excluded gain.

Withdrawals from Merchant Marine capital construction fund. Nonqualified withdrawals from a Merchant Marine capital construction fund by a noncorporate taxpayer are taxed at 20 percent.

Withholding by domestic partnerships, estates and trusts. The IRS, by regulation, may reduce the amount of tax withheld on a foreign person's gain from the disposition of a U.S. property interest to *20 percent.* If the IRS does not make such provision in its regulations, the domestic partnership, estate, or trust must withhold tax at a rate of 35 percent. Previously, the IRS had the authority to reduce the withholding from 35 percent to 28 percent.

Planning Note. This provision only impacts U.S. partnerships, estates, and trusts that dispose of interests in U.S. real property and distribute a portion of the gain to a foreign person who is a partner or beneficiary. If the partner or beneficiary is not a foreign person, no withholding is required.

PRACTICAL ANALYSIS. Wally Head, Managing Director, Chicago office of Sanford C. Bernstein & Co., Inc., provides these observations regarding how the new 20-percent tax rate on long-term capital gains will impact marketable-security asset allocation decisions by individual investors.

Generally, the lower tax rate on long-term capital gains will increase the long-term, after-tax equity risk premium. This will justify increased allocations to equities by investors who base their asset allocation decisions on risk/return analyses. Conversely, investors who invest in equities — versus cash or bonds—

only to the extent necessary to achieve identifiable goals will be able to decrease their allocations to equities.

The lower long-term capital gains tax rate makes contributions to non-tax-deductible deferral strategies (e.g., purchases of commercial annuities) that will be invested in equities much less attractive now from an investment perspective. This lower tax rate reduces somewhat the attractiveness of tax-deductible deferral strategies (e.g., contributions to qualified retirement plans) that will be invested in equities, but this reduction is offset for many investors by the elimination of exposure to the 15-percent excise tax on excess distributions and accumulations. On balance, therefore, most investors will still find it attractive to make maximum contributions to *tax-deductible* deferral strategies.

Should equities be overweighted in or outside of tax deferral strategies? While the lower rate on long-term capital gains does increase the attractiveness of overweighting equities outside of tax deferral strategies, the answer to this important question remains very fact-specific. In addition to the factors that existed previously, it is important to recognize that only a portion of the return produced by most equity managers—in separately managed accounts or mutual funds—will qualify for the lower rate. Additionally, growth that occurs outside of tax-deferral strategies remains outside of them and is exposed to rates which may be higher in the future. Given the reluctance most investors have to paying taxes any earlier than necessary, the benefits provided to some investors by the repeal of the 15-percent excise tax on excess distributions and accumulations, and the power of compounding returns without current taxation, we don't expect many investors will begin overweighting equities outside of their tax-deferral strategies.

Effective date. This provision generally applies to tax years ending after May 6, 1997.

Act Sec. 311(a), amending Code Sec. 1(h); Act Sec. 311(b)(1), adding new Code Sec. 55(b)(3); Act Sec. 311(b)(2), amending Code Sec. 55(b)(1)(A) and Code Sec. 57(a)(7); Act Sec. 311(c), amending Code Sec. 1445(e)(1), Code Sec. 904(b)(2) and Code Sec. 7518(g)(6)(A); Act Sec. 311(d) and Act Sec. 311(e). Law at ¶ 5001, 5029, 5033, 5287, and 5407. Committee Report at ¶ 10,295.

Corporate Capital Gains Rate

¶ 305

Background

When a corporation has a net capital gain for a particular tax year, the corporation will pay an alternative tax if such tax is less than the income tax computed in the regular manner. Under prior law, the alternative tax imposed a 35-percent tax rate on a corporation's net capital gain.

Alternative tax computation modified.—The alternative tax rate of 35 percent is now applied to the lesser of the corporation's net capital gain or its

taxable income. Previously, the 35-percent rate applied only to the corporation's net capital gain.

Planning Note. The alternative minimum tax rate only applies when a corporation's ordinary income tax rate *exceeds* 35 percent. Therefore, this change has no immediate impact on corporations because the top corporate tax rate is currently 35 percent.

Effective date. This provision applies to tax years ending after December 31, 1997.

Act Sec. 314(a), amending Code Sec. 1201(a)(2). Law at ¶ 5341. Committee Report at ¶ 10,325.

Small Business Stock

¶ 306

Background

Since the Revenue Reconciliation Act of 1993, an exclusion from gross income for individuals is allowed on 50 percent of any gain from the sale of qualified small business stock acquired at original issue and held at least five years. The amount of gain eligible for the exclusion by an individual with respect to a corporation is the greater of 10 times the taxpayer's basis in the stock or $10 million.

In general, to qualify as a small business, the issuing corporation must have had gross assets not exceeding $50 million at the time the stock was issued, it must satisfy an active trade or business requirement, and it must be a domestic Subchapter C corporation. A myriad of conditions and specifics apply in defining stock eligible for the 50-percent exclusion under Code Sec. 1202, all of which is unchanged by the Taxpayer Relief Act of 1997.

Prior to the Act, no provision specifically addressed the treatment of gain from the sale of small business stock where the sale proceeds were used to purchase other small business stock. Because no rollover provision existed or other relief applied to the purchase of replacement small business stock, such gains were taxable, although the seller could benefit from the 50-percent exclusion if it held the stock sold for more than five years.

Rollover of gain from sale of qualified stock.—An individual may elect to roll over capital gain from the sale of qualified small business stock held for more than six months if other small business stock is purchased by the individual during the 60-day period beginning on the date of sale. Accordingly, gain is recognized only to the extent that the amount realized on the sale exceeds the cost of the replacement small business stock purchased during the 60-day period, as reduced by the portion of such cost, if any, previously taken into account. To the extent that capital gain is not recognized, that amount will be applied to reduce the basis of the replacement small business stock. The basis adjustment is applied to the replacement stock in the order such stock is acquired.

Replacement stock. For purposes of the rollover provision, the replacement stock must meet the active business requirement for the six-month period following its purchase. Except for purposes of determining whether the active business test six-month holding period is met, the holding period of the stock purchased will include the holding period of the stock sold.

> **Example.** Bill Morgan farms and invests $500,000 in XYZ Corporation, a manufacturer of widgets, on October 5, 1997. XYZ is a qualified small

business. On September 1, 1998, Morgan sells his XYZ stock for $750,000. On September 25, 1998, he purchases stock in the newly formed ABC Corporation, a manufacturer of widget components, for $700,000. ABC is also a qualified small business. Thus, Morgan recognizes a $50,000 gain on the sale of XYZ stock. His basis in the ABC stock is $500,000. The holding period of his XYZ stock is tacked onto the holding period of his ABC stock for all purposes except for determining whether ABC Corporation meets the active business requirement. Thus, for applying the 50 percent exclusion of Code Sec. 1202 and other purposes, his holding period for the ABC stock began on October 5, 1997.

PRACTICAL ANALYSIS. George Jones, Esq., of CCH INCORPORATED, New York, N.Y., observes that this provision opens up a new way to defer tax on the gain of a portion of an investment portfolio—that devoted to qualified startup ventures—indefinitely. The new provision also gives more flexibility to those presently invested in "section 1202" stock: the benefit of the 50 percent gain exclusion on "section 1202" qualified small business stock is not available to anyone until August 12, 1998, since the controlling Code provision requires a more than five-year holding period for qualified small business stock issued after August 10, 1993. The '97 Tax Act provision—through its new reinvestment/rollover option—allows an investor in effect to bail out of a particular section 1202 investment early and preserve tax benefits. The new provision gives a significant boost to small cap companies looking for venture capital and no doubt will create a new marketing opportunity for those brokers who make rollover opportunities more available. And unlike a similar provision under which gain on publicly traded securities can be deferred if the proceeds are invested within 60 days in a specialized investment company (organized under the Small Business Investment Act to encourage business ownership by socially or economically disadvantaged persons), the '97 Tax Act rollover can be directed toward companies with less risk and/or more potential for capital appreciation.

Effective date. The provision applies to sales after August 5, 1997.

Act Sec. 313(a), adding Code Sec. 1045; Act Sec. 313(b), amending Code Sec. 1016(a), redesignating Code Sec. 1223(15) as Code Sec. 1223(16) and adding new Code Sec. 1223(15); Act Sec. 313(c). Law at ¶ 5317, 5333 and 5343. Committee Report at ¶ 10,320.

Gains and Losses from Terminations of Certain Property

¶ 307

Background

Capital gain or loss treatment requires a "sale or exchange" of a capital asset, which has been more narrowly defined than gain from a "sale or other disposition." Prior to the Taxpayer Relief Act of 1997, taxpayers were effectively provided with an election through case law and Code inconsistencies to achieve either capital gain or ordinary loss treatment in some transactions. The Code specifically deemed "sale or exchange" treatment for some transactions, including the gains and losses

Background

attributable to the cancellation, lapse, expiration or other termination with respect to certain personal property. Nonactively traded personal property did not fall under this capital treatment. Further, under prior law, capital treatment was given to gain or loss on the retirement of debt obligations, except for debt issued by a natural person or debt issued before July 2, 1982, by a noncorporate nongovernmental issuer. Also, under prior law, no provisions specifically addressed the tax treatment to be used when the property in a short sale became substantially worthless.

Capital treatment extended.—The "sale or exchange" treatment of gain or loss from the cancellation, lapse, expiration or other termination of a right or obligation with respect to certain property that is a capital asset in the hands of the taxpayer is extended to all property. Specifically, capital treatment of gains and losses under the "sale or exchange" rule of Code Sec. 1234A is extended to cover interests in real property and nonactively traded personal property.

Affected property. An example of how the new tax treatment affects an interest in real property is that capital gains treatment could apply to amounts received to release a lessee from a requirement that the premises be restored on termination of the lease. An example of the new treatment on nonactively traded personal property is that capital treatment could apply to the forfeiture of a down payment under a contract to purchase stock that is a capital asset.

Caution. The House Committee Report states that this provision does not affect whether a right is "property" or whether property is a "capital asset."

Short sales and worthless property. If a taxpayer enters into a short sale of property and the property becomes substantially worthless, the taxpayer recognizes gain in the same manner as if the short sale was closed when the property became substantially worthless. Regulations will be provided as to similar treatment for any option with respect to property, any offsetting notional principal contract with respect to property, any futures or forward contract to deliver any property, and any other similar transaction.

If a short sale remains open when property becomes substantially worthless, the statute of limitations period for the assessment of any deficiency attributable to any part of the gain on the transaction will not expire before the earlier of the date that is three years after the date the IRS is notified by the taxpayer of the substantial worthlessness of the property (in a manner to be prescribed by the Secretary) or the date that is six years after the date the return for that tax year is filed.

Debt issued by natural persons. The new law also repeals the provision that exempts debt obligations issued by natural persons from the rule that treats gain or loss realized on retirement of the debt as gain or loss realized on an exchange. Thus, gain or loss on the retirement of this type of debt is capital gain or loss if the debt is a capital asset. The provision retains the present-law exceptions to "exchange" treatment for debt issued before July 2, 1982, by noncorporations or nongovernments.

PRACTICAL ANALYSIS. Steven Surdell of Jenner & Block, Chicago, Ill., observes that Congress first enacted Code Sec. 1234A in 1981 in order to preclude what it considered the opportunity for elective characterization of gain or loss on non-sale asset disposi-

tions. This opportunity stemmed from the common law distinction between asset dispositions pursuant to a sale or exchange, on the one hand, or pursuant to a lapse, expiration, cancellation, or abandonment, on the other hand. In the latter case, the courts generally held that the gain or loss on the lapse, expiration, cancellation, or abandonment was ordinary. *See, e.g., Leh v. Commissioner,* CA-9, 58-2 USTC ¶ 9889, 260 F.2d 489; *Commissioner v. Pittston Co.,* CA-2, 58-1 USTC ¶ 9284, 252 F.2d 344. This distinction leads to a possible character arbitrage in which, for example, a taxpayer could enter into corresponding long and short futures positions on the same underlying commodity. After a movement in the commodity's price, the taxpayer could cancel the loss leg of the transaction by a cash settlement (thus recognizing ordinary loss) and sell or assign the gain leg (thus recognizing capital gain). Code Sec. 1234A was enacted to preclude this character arbitrage.

As originally enacted, however, Code Sec. 1234A applied only to actively traded personal property as defined under the straddle rules of Code Sec. 1092. The modification of Act Sec. 1002 broadens Code Sec. 1234A to "property" which is presumably all property. The modification clarifies the character of the gain or loss on some of the more common derivative transactions. For example, if parties enter into a notional principal contract on a nonpublicly traded financial asset (such as an equity swap on a nonpublicly traded stock) and one of the parties makes a termination payment in order to terminate its obligation under the swap agreement, the character of this termination payment was unclear under prior law. It is now clear that the payment will generate capital gain or loss.

Effective date. The extension of the extinguishment rule applies to terminations more than 30 days after August 5, 1997 (September 5, 1997). The short sales provision applies to property that becomes substantially worthless after August 5, 1997. The repeal of the exception for debt issued by natural persons applies to debt issued or purchased (within the meaning of Code Sec. 1272(d)(1)) after June 8, 1997.

Act Sec. 1003(a)(1), amending Code Sec. 1234A(1); Act Sec. 1003(b)(1), adding Code Sec. 1233(h); Act Sec. 1003(c)(1), amending Code Sec. 1271(b); Act Sec. 1003(a)(2), Act Sec. 1003(b)(2), Act Sec. 1003(c)(2). Law at ¶ 5345, 5347, and 5357. Committee Report at ¶ 11,130.

APPRECIATED FINANCIAL POSITIONS

Constructive Sale Treatment

¶ 308

Background

In general, gain or loss is not recognized on an asset until the asset is sold, exchanged or otherwise disposed of by the owner. The disposition of the asset shifts the benefits and burdens of ownership to another party and fixes the amount of gain or loss. This amount is the difference between the amount realized and the taxpayer's basis in the asset.

Background

Prior to enactment of the Taxpayer Relief Act of 1997, however, certain hedging transactions were allowed that enabled taxpayers to lock in gain or loss on an asset without current recognition of gain. Such transactions are substantially equivalent to a sale because they shift the opportunity for further gain and the risk of further loss.

The best known of these hedging strategies is the "short sale against the box." In this transaction, a taxpayer who owns appreciated shares of stock borrows identical shares from a broker and sells them. No gain or loss is recognized at the time of the short sale. The proceeds of the sale are held by the broker until the taxpayer closes the transaction by delivering replacement shares. These replacement shares can be either the securities held or newly purchased securities.

Gain or loss is recognized only when the transaction is closed. The amount of gain or loss is the difference between the proceeds the taxpayer received from the short sale and the cost of the shares used to cover the borrowed shares. Note that if the shares originally held by the taxpayer are used to cover the short sale, the amount of the gain was fixed at the time of the short sale. The amount of gain locked in was the difference between the taxpayer's basis in the shares and the amount of the proceeds from the borrowed shares. Characterization of the gain as long-term or short-term depends on the taxpayer's holding period for the original stock as of the time of the short sale.

Other hedging strategies that shift the benefits and burdens of ownership without current recognition of gain are forward contracts and offsetting notional principal contracts. In a forward contract, a taxpayer agrees to sell a specified number of shares of stock at a specified time in the future for a specified price. The amount of gain is the difference between the specified price and the taxpayer's basis. Although this amount is locked in at the time the contract is created, there is no current recognition of gain. Futures contracts are similar to forward contracts except that they are normally traded on an exchange and generally do not have an exact delivery date, the date of delivery being specified by the exchange.

An offsetting notional principal contract is an agreement by one party to pay the investment yield on specified property for a specified time to a counterparty in exchange for the right to be reimbursed for any decline in the value of the property. In effect, one party takes a short position with respect to the property and the other takes a long, or ownership position.

General rule, appreciated financial positions.—Prior to the Act, certain hedging strategies such as "short sales against the box," forward contracts, and notional principal contracts could be used to lock in gains on appreciated financial positions without immediate recognition of income. New Code Sec. 1259 limits an investor's ability to do this by treating certain hedging transactions as constructive sales.

The Act provides that if there is a constructive sale of an appreciated financial position, the taxpayer must recognize gain as if such position were sold, assigned, or otherwise terminated at its fair market value as of the date of the constructive sale and immediately repurchased. Appropriate adjustments would be made in the amount of any gain or loss subsequently realized on the position to reflect the gain recognized on the constructive sale. The taxpayer's holding period in the position would begin as if the taxpayer had first acquired the position on the date of the constructive sale.

Caution. Taxpayers may not recognize any loss on the constructive sale of an appreciated financial position.

Appreciated financial position. The term "appreciated financial position" generally means any position with respect to any stock, debt instrument, or partnership interest where there would be gain if such position is sold, assigned, or otherwise terminated at its fair market value. However, there are two exceptions. One exception is made for any position that is marked to market. A second exception is made for any position with respect to debt instruments if three conditions are satisfied:

(1) the debt unconditionally entitles the holder to receive a specified principal amount;

(2) the interest payments (or other similar amounts) with respect to the debt are payable based on a fixed rate or, to the extent provided in regulations, at a variable rate (Code Sec. 860G(a)(1)(B)(i)); and

(3) the debt is not convertible, either directly or indirectly, into stock of the issuer or any related person.

Constructive sale. A taxpayer is treated as making a constructive sale of an appreciated position if the taxpayer enters into certain types of transactions or attempts to avoid the purposes of Code Sec. 1259 by having a related person enter into one of these transactions. For this purpose, the term "related person" has the meaning given that term under Code Sec. 267 or 707(b). A constructive sale is deemed to occur when a taxpayer does any of the following:

(1) enters into a short sale of the same or substantially identical property;

(2) enters into an offsetting notional principal contract with respect to the same or substantially identical property;

(3) enters into a futures or forward contract to deliver the same or substantially identical property;

(4) has entered into a short sale, an offsetting notional principal contract or a forward or futures contract and acquires the same property as the underlying property for the position (acquires a long position in the same property); or

(5) to the extent prescribed in regulations, enters into other transactions having substantially the same effect as the four types of transactions listed above.

In a short sale, a taxpayer who owns appreciated shares of stock borrows identical shares from a broker and sells them. The proceeds of the sale are held by the broker until the taxpayer closes the transaction by delivering replacements for the borrowed shares. These replacement shares can be either the securities originally held by the taxpayer or newly purchased securities.

In a forward contract, a taxpayer agrees to sell specified property, such as a specified number of shares of stock, at a specified time in the future for a specified price. New Code Sec. 1259 provides that for a forward contract to result in a constructive sale, it need only provide for delivery of a *substantially* fixed amount of property at a *substantially* fixed price. There is no constructive sale, however, if

there is room for *significant* variation in the terms of the contract. Note that the Conference Committee Report states that the conferees do not intend that an agreement that is not a contract under applicable contract law will be treated as a forward contract.

An offsetting notional principal contract is an agreement by one party to pay the investment yield on specified property for a specified time to a counterparty in exchange for the right to be reimbursed for any decline in the value of the property. In effect, one party takes a short position with respect to the property while the other takes a long, or ownership position. To result in a constructive sale under new Code Sec. 1259, the contract need only provide a requirement to pay *substantially* all of the investment yield in exchange for the right to be reimbursed for *substantially* all of any decline in value in the position.

The Senate Committee Report gives considerable guidance on the types of transactions that the Treasury Department might, in future regulations, deem to have the same effect as the four enumerated transactions included in the statute. Included transactions would be those that eliminate virtually all risk of future loss and opportunity for future gain. For a detailed discussion of what types of transactions might be expected to be included in the regulations see ¶ 311, below.

In addition, the Conference Committee Report states that the conferees intend that the constructive sale provision will generally apply to transactions that are identified as hedging or straddle transactions under other Code provisions (e.g., Code Secs. 1092, 1221 and 1256).

Excluded from the definition of a constructive sale are contracts for the sale of appreciated financial assets that are not marketable securities (within the meaning of Code Sec. 453(f)). The exception only applies, however, if the contract settles within one year after the date it was entered into.

Operation of the general rule is illustrated below.

Example. Mary Smith owns 1,000 shares of ABC stock. The stock has a basis of $75 per share and a current fair market value of $100 per share. Smith decides to enter into a short sale against the box. She borrows 1,000 shares of ABC stock from her broker and sells them for the current market price of $100 per share, making the total proceeds from the sale $100,000. This $100,000 will be held by the broker until Smith delivers 1,000 shares of ABC stock to the broker at some time in the future to cover for the borrowed shares.

Note that immediately after the short sale Smith has effectively locked in her selling price of $100 per share and her total profit of $25,000. Regardless of what happens to the stock price in the future, any change in her long position (holding the original 1,000 shares in the hope that their price will increase) will be exactly offset by a change in her short position (selling the shares). For instance, suppose the price of the stock drops to $80 per share. This would reduce Smith's gain on her long position (the shares she still holds) by $20,000 (100 shares at $20 per share). At the same time, however, Smith can cover her debt to the broker by transferring the 1,000 shares of ABC she owns. Although these shares are worth only $80,000 now, they can be transferred to the broker in exchange for the $100,000 that is being held for her.

Under new Code Sec. 1259, Smith would be treated as having an appreciated position in the ABC stock because she entered into a short sale, and the fair market value of the stock exceeds her basis in the stock. The exception for

nonmarketable assets would not apply, and her short sale against the box (one of the listed transactions) should be treated as a constructive sale. Smith would recognize a gain of $25,000 on the sale ($100,000 proceeds minus $75,000 basis in the stock). Smith's basis in the stock would be stepped up to $100,000 to reflect the gain recognized on the constructive sale.

Smith will subsequently transfer her original 1000 shares of ABC to the broker in exchange for her $100,000. The amount of gain recognized on this transaction would be the amount of the proceeds minus the basis of the stock used to cover. Although Smith's original basis in the ABC stock was $75 per share, it should be stepped up to $100 per share because Smith was treated as repurchasing the shares for their fair market value as of the time of the constructive sale. As a result, no gain or loss is recognized at the time the transaction is closed.

PRACTICAL ANALYSIS. Steven Surdell of Jenner & Block, Chicago, Ill., points out that new Code Sec. 1259 descends directly from the various Clinton Administration constructive-sale initiatives which began with the so-called Pearl Harbor Day proposals of December 7, 1995. The earlier proposals responded to what the Administration perceived as the widespread use (or abuse, in the eyes of the Administration) of short against the box and similar transactions to defer, or possibly eliminate, built-in gains on financial assets (e.g. the Estee Lauder transaction). Numerous commentators questioned the breadth of the earlier proposals, suggesting, among other things, that the provisions could have broad and unintended collateral consequences and that the provisions were perhaps inconsistent with certain existing tax code provisions such as the straddle rules of Code Sec. 1092, the wash-sale rules of Code Sec. 1091 and the dividends-received deduction rules of Code Sec. 246.

The final Code Sec. 1259 language is significantly narrower than the original Administration proposals and appears to target a more limited universe of transactions. The constructive sale definition would apply to short against the box transactions, full return equity swaps, forward sales and, under Treasury regulations to be issued, any transactions having substantially the same effect. Based upon the section's definitions, it appears that the constructive sale label generally attaches only to those transactions which eliminate all, or virtually all, of the appreciated position's economic upside and downside (although the definition of an "offsetting notional principal contract" includes any notional principal contract which swaps "all or *substantially all*" of the underlying asset's yield for a specified period).

Because the final language is narrower than the earlier proposed language, taxpayers may still consider entering into many common risk-minimization techniques—but must do so cautiously. One technique which appears to have gained a limited blessing as a part of the Act is the so-called zero premium collar transaction. Such transactions typically entail the taxpayer's purchase of a put option on the underlying stock (or other appreciated financial asset) and the sale of a call option on the same stock. The put

option protects the taxpayer's downside risk—which is often all the taxpayer really desires. Given the relatively high valuation in today's equity markets, many investors seek to protect themselves from downside risk for a fairly limited time period—such as over the next 12 months—but desire to hold the stock long term. Other investors would like to sell stock and recognize the built-in gain, but cannot do so because the stock is subject to transfer restrictions imposed by securities laws or contractual agreements. These investors might consider purchasing a put option on their appreciated shares. Because the put option premium may be significant, however, taxpayers essentially finance the put option premium by selling a call option to the same counter party. The strike price on the sold call option is set so that the option premium received by the taxpayer on the call offsets the option premium paid by the taxpayer on the purchased put option—hence the name zero premium (or zero cost) collar.

The Conference Committee Report expressly notes that Treasury regulations will provide guidance on collar transactions which guidance will "provide standards for determining which collar transactions result in constructive sales." The report notes that the conferees "expect that these Treasury regulations with respect to collars will be applied prospectively, except in cases to prevent abuse." It thus appears that taxpayers may enter into collar transactions but will need to consider whether the collar eliminates excessive amounts of both upside potential and downside risk. Such assessments will need to be made on a transaction-by-transaction basis and will need to take into account such factors as the duration of the collar, how tight the collar is around the applicable financial asset, and the volatility of that asset. These factors, of course, are fundamental to most option-pricing models. As a result, taxpayers should focus particular attention on the options pricing which is incorporated into any collar transaction. In the final analysis, it appears that taxpayers should generally feel comfortable engaging in collar transactions, but only after carefully considering the facts and circumstances as described above.

Steven Surdell also points out that one category of large corporate transactions which clearly appear to have survived the constructive sale chopping block are the so-called DECS®-type of transactions, which allow the holder of an appreciated portfolio stock to hedge its downside risk in the stock and to monetize the appreciation.

Effective date. The provision is generally effective for constructive sales entered into after June 8, 1997. For special transitional rules, see ¶ 312.

Act Sec. 1001(a), adding Code Sec. 1259; Act Sec. 1001(d). Law at ¶ 5355. Committee Report at ¶ 11,115.

Safe Harbor

¶ 309

Safe harbor for short-term hedges.—Code Sec. 1259 provides a safe harbor for certain short-term hedges that would otherwise be treated as constructive sales. Under this exception, a transaction that would otherwise be treated as a constructive sale will be disregarded if three conditions are satisfied:

(1) the transaction is closed before the end of the 30th day after the end of the tax year in which the transaction was entered into;

(2) the taxpayer holds the appreciated financial position throughout the 60-day period beginning on the date the transaction is closed; and

(3) at no time during such 60-day period is the taxpayer's risk of loss with respect to the position reduced by a circumstance that would be described in Code Sec. 246(c)(4) if references to stock included references to such position.

The circumstances referred to in Code Sec. 246(c)(4) are as follows:

(1) the taxpayer has an option to sell, is under a contractual obligation to sell, or has made (but not closed) a short sale of substantially identical stock or securities;

(2) the taxpayer is the grantor of an option to buy substantially identical stock or securities; or

(3) under regulations prescribed by the Treasury Department, the taxpayer has diminished his or her risk of loss by holding one or more other positions with respect to substantially similar or related property.

If a transaction that is closed is reestablished in a substantially similar position, the exception still applies, provided that the reestablished position is closed prior to the end of the 30th day after the close of the taxable year in which the original transaction occurred, and the taxpayer satisfies the two 60-day rules described above.

Planning Note. Although new Code Sec. 1259 prevents taxpayers from locking in gain and reducing future market risk to zero, they need only be exposed to risk for a relatively short period during the year. Further, even during this exposure period, taxpayers with appreciated positions may still be able to enter into other risk-reduction techniques such as certain collars during the time during which they must be exposed to market risk. For an explanation of how collars work, see ¶ 311, below.

PRACTICAL ANALYSIS. Steven Surdell of Jenner & Block, Chicago, Ill., notes that a special rule allows taxpayers to avoid constructive sale characterization if (1) the would-be constructive sale is closed within 30 days after the end of the year in which it was first opened, (2) for 60 days after the transaction is closed the taxpayer holds the appreciated financial position, and (3) during the 60-day period, the taxpayer does not enter into a risk-reduction transaction which would, under Code Sec. 246(c)(4), toll the holding period for dividends-received deduction purposes. Code Sec. 246(c)(4) tolls the holding period of a stock if the holder enters into certain risk-reduction techniques such as having an option to sell, being under an obligation to sell, being a party to an

open short sale in respect of the same or substantially identical stock or securities, granting an option to buy substantially identical stock or securities, or, under Treasury regulations, diminishing risk of loss by entering into one or more positions with respect to substantially similar or related property.

Because the Treasury regulations under Code Sec. 246(c)(4)(c) allow parties to enter into certain market hedges which are not deemed substantially similar or related property, the closed transaction provision of new Code Sec. 1259 would not appear to preclude such a hedge. Thus, it appears that a taxpayer may enter into a short against the box (or similar transaction) so long as it is closed out within 30 days of year-end. After closing out the position, the taxpayer must hold the stock for the 60-day holding period prescribed by Code Sec. 1259(c)(3)(A)(iii), but the taxpayer could enter into market or other hedges which would not constitute substantially similar or related property under the Code Sec. 246(c)(4)(c) regulations. Taxpayers would also want to carefully analyze such transactions, however, to assure themselves that their positions pass muster under some of the common-law doctrines, such as substance over form. In addition, the Conference Committee Report states that, under regulations to be issued by the Treasury, either a taxpayer's appreciated financial position or an offsetting position may, in certain circumstances, be considered on a disaggregated basis for purposes of the constructive sale analysis. The prospect of such a disaggregation would also need to be considered in respect of a market hedge.

Effective date. The provision is generally effective for constructive sales entered into after June 8, 1997. For special transitional rules, see ¶ 312.

Act Sec. 1001(a), adding Code Sec. 1259(c)(3); Act Sec. 1001(d). Law at ¶ 5355. Committee Report at ¶ 11,115.

Special Rules

¶ 310

Special rules, appreciated financial positions.—Special rules are provided for subsequent sales of positions that were deemed sold in constructive sales, certain trust instruments, and multiple positions in property. The Secretary of the Treasury is directed to prescribe such regulations as may be necessary to carry out the purposes of these special rules, as well as the other rules for constructive sales of appreciated financial positions.

Subsequent sales. A transaction that resulted in a constructive sale of an appreciated financial position is not treated as resulting in a constructive sale of another appreciated financial position so long as the taxpayer continues to hold the position that was treated as constructively sold. When the position is sold, assigned or otherwise disposed of, however, the taxpayer is deemed to have entered into the transaction that resulted in the constructive sale at that time.

Example. Tom Johnson holds two appreciated stock positions and one offsetting short sale and identifies the short sale as offsetting one of the stock positions. If Johnson then sells the stock position that was identified, the

identified short position would cause a constructive sale of the taxpayer's other stock position at that time.

Certain trust instruments. An interest in a trust that was actively traded (within the meaning of Code Sec. 1092(d)(1)) is generally treated as stock for purposes of the constructive sale rules of Code Sec. 1259. An exception is made, however, if substantially all of the property held by the trust (measured by value) is debt described in the debt exception to the definition of appreciated financial position in new Code Sec. 1259(b)(2)(A). Debt qualifies for this exception if (1) the debt unconditionally entitles the holder to receive a specified principal amount, (2) interest payments with respect to the debt meet the requirements of Code Sec. 860G(a)(1)(B), and (3) the debt is not convertible (directly or indirectly) into stock of the issuer or a related person.

Multiple positions in property. If a taxpayer holds multiple positions in property, the determination of whether a specific transaction is a constructive sale and, if so, which appreciated financial position is deemed sold, is made in the same manner as actual sales.

The Senate Committee Report notes that more than one appreciated financial position or more than one offsetting transaction can be aggregated to determine whether a constructive sale has occurred. For example, it is possible that no constructive sale would result if the appreciated financial position and one offsetting transaction were considered in isolation, but that a constructive sale would result if the appreciated financial position were considered in combination with two transactions.

Where the standard for a constructive sale is met with respect to only a pro rata portion of a taxpayer's appreciated position (e.g., some, but not all shares of stock), that portion would be treated as constructively sold. In addition, if there is a constructive sale of less than all of any type of property held by the taxpayer, the specific property deemed sold would be determined under the rules governing actual sales, after adjusting for previous constructive sales. Finally, the Senate Committee Report notes that the future regulations may provide that either a taxpayer's appreciated financial position or its offsetting transaction, be disaggregated on a non-pro rata basis in some circumstances for purposes of the constructive sale determination.

Effective date. The provision is generally effective for constructive sales entered into after June 8, 1997. For special transitional rules, see ¶ 312.

Act Sec. 1001(a), adding Code Sec. 1259(e); Act Sec. 1001(d). Law at ¶ 5355. Committee Report at ¶ 11,115.

Regulations

¶ 311

Regulations on definition of constructive sale.—Code Sec. 1259 provides that a taxpayer will be deemed to have made a constructive sale of an appreciated financial position if the taxpayer or a related person enters into any of four enumerated transactions; a short sale, an offsetting notional principal contract, a futures or forward contract, or acquisition of a long position in the same asset. It also gives the Treasury Department authority to issue regulations that are necessary or appropriate to carry out the purposes of this provision, including the regulatory authority to treat other transactions that have the same effect as the enumerated transactions as constructive sales.

The Senate Committee Report sets forth in some detail what should be expected in these regulations. In general, the additional transactions that will be treated as constructive sales are those that have the effect of substantially eliminating *both* the taxpayer's risk of loss and opportunity for gain with respect to the appreciated financial position. Transactions that do only one should not be included. For example, a taxpayer who has an appreciated financial position and enters into a put option with an exercise price equal to the current market price (an "at the money" option) has eliminated risk of loss, but not opportunity for gain.

> **Example (1).** Ann Davis owns 100 shares of XYZ stock with a basis of $40 per share. The stock is currently trading for $100 per share. Davis buys a put option with an exercise price of $100. In other words, Davis has the right to sell the shares at $100. Note that Davis has eliminated her risk of loss. If the stock price drops below $100, Ann can exercise the put and still get $100 per share for the stock. On the other hand, Davis has not eliminated her opportunity for gain. If the price of XYZ goes above $100 per share, she can forgo exercising the option and sell the stock for its current market value.

The Senate Committee Report goes on to state that it is anticipated that the regulations will provide specific standards for determining whether common transactions that eliminate only a portion of future risk and opportunity for profit such as collars or "in-the-money" options will be treated as constructive sales. In a collar, a taxpayer sells a call and buys a put with a lower strike price. In other words, the taxpayer is required to sell a position at a fixed price (the call strike price) and has the right to sell the position at a lower price (the put strike price). According to the conferees, it is anticipated that future regulations on collars will be applied prospectively, except for abusive situations.

> **Example (2).** Bill Stark owns 100 shares of Newco stock. The stock is currently selling for $100 per share. Stark sells a call with a strike price of $110 and buys a put with a strike price of $95. Note that a call is a right to buy at a given price and a put is a right to sell at a given price. Selling a call means selling someone else the right to buy from you at a given price at some time in the future.
>
> The effect of this transaction is that Stark has transferred the rights to all gains above $110 and all loss below $95. If the stock price rises above $110, Stark is still obligated to sell it for $110 to the party that purchased the call. If the price drops below $95, Stark still has the right to sell the shares for $95.

The collar in Example (1), above, left Stark with substantial risk of future loss and opportunity for future gain. He could lose up to five dollars per share and gain up to $10 per share. The regulations will provide specific rules for determining how much risk of loss and opportunity for gain a collar can allow without resulting in a constructive sale. Relevant variables are the spread between the put and call prices and the period of the transaction.

Rules will also be provided for an "in-the-money" option. This term refers to put options in which the strike price is significantly above the current market price or a call option in which the strike price is significantly below the current market price.

> **Example (3).** Carol Anderson owns stock with a current price of $100 per share. She buys a put option on the shares with a strike price of $120. In other words, Anderson has the right to sell the stock at $120 per share at some time in the future. The effect of this transaction is to eliminate all risk of loss

on the transaction, and to lock in a gain of at least $20. Note that Anderson has not eliminated all possibility of future gain, however. If the price of stock rises above $120, she will forgo exercising the put option and sell the stock for its market price. Purchasing a put option like this would, of course, be quite expensive. The cost of the put option would have to be taken into account in determining the amount of actual gain that could be locked in.

Effective date. The provision is generally effective for constructive sales entered into after June 8, 1997. For special transitional rules, see ¶ 312.

Act Sec. 1001(a) adding Code Sec. 1259(c)(1)(E); Act Sec. 1001(d). Law at ¶ 5355. Committee Report at ¶ 11,115.

Effective Date

¶ 312

Effective date and transitional rules.— New Code Sec. 1259 generally applies to any constructive sale after June 8, 1997. There are two special transitional rules, however—one for sales of positions held before June 9, 1997, and one for decedents dying after June 8, 1997.

Constructive sales before June 9, 1997. A special rule applies to transactions before June 9, 1997, that would otherwise have been constructive sales under Code Sec. 1259. The positions in such a transaction and the property to which the position relates are not taken into account in determining whether any other constructive sale has occurred after June 8, 1997, if, before the close of the 30-day period beginning on August 5, 1997 or before such later date as the Secretary of the Treasury may specify, such transaction and position are clearly identified as offsetting. This special rule will cease to apply when the transaction is closed or the taxpayer ceases to hold such position.

Decedents. If a decedent dies after June 8, 1997, and there was a constructive sale of an appreciated financial position on or before that date, such position and the related property will be treated as property constituting rights to receive income in respect of a decedent (IRD) if three conditions are satisfied:

(1) the transaction resulting in the constructive sale treatment remains open (with respect to the decedent or any related person) for at least two years after the date of such transaction;

(2) the transaction remains open at any time during the three-year period ending on the date of the decedent's death; and

(3) the transaction is not closed within the 30-day period beginning on August 5, 1997.

Code Sec. 1014(c) (denying a date-of-death basis for IRD items) is inapplicable to the excess of the position's or property's value (as included in the decedent's estate for estate tax purposes) over its fair market value on the date the transaction is closed. In other words, gain with respect to a position accruing after the transaction is closed will not be included in income in respect of a decedent.

Act Sec. 1001(c) and (d). Law at ¶ 5355.

NET OPERATING LOSSES

Carryback and Carryforward Periods

¶ 315

Background

Under prior law, a net operating loss (NOL) sustained in a tax year could be carried back three years and carried forward 15 years to offset taxable income in those years.

Net operating loss carryback and carryforward periods modified.—The net operating loss (NOL) of a taxpayer, which is generally the excess of the taxpayer's business deductions over its gross income, may be carried back and applied against taxable income for prior years and then carried forward and applied against taxable income for years after the NOL year. Under the Act, the NOL carryback period is shortened to two years (from three years), but the NOL carryforward period is extended to 20 years (from 15 years). Special carryback rules relating to (1) real estate investment trusts (REITs) that do not receive carrybacks; (2) specified liability losses that are subject to a 10-year carryback; (3) excess interest losses that do not receive carrybacks; and (4) corporate capital losses are not affected by the changes.

The three-year carryback period is retained for the portion of the NOL that relates to casualty and theft losses of individual taxpayers and to NOLs that are attributable to Presidentially declared disasters and are incurred by taxpayers engaged in farming or by a small business. For this purpose, a small business means any trade or business (including one conducted in or through a corporation, partnership, or sole proprietorship) the average annual gross receipts of which are $5 million or less for a three-tax-year period (as determined under Code Sec. 448(c)), and a farming business is defined in Code Sec. 263A(e)(4).

> **Example (1).** In 1998, Ken Hubbs, the sole proprietor of a small business, has a net operating loss of $66,000. In past years, Hubbs reported the following amounts of taxable income: 1995—$82,000, 1996—$10,000, and 1997—$4,000. The NOL can be carried back two years to 1996 and 1997 and can offset $14,000 ($10,000 + $4,000) of taxable income from those years. The remaining NOL of $52,000 ($66,000 − $14,000) can be carried forward for 20 years.

> **Example (2).** Assume the same facts as Example (1), above, except that the 1998 NOL was entirely due to a Presidentially declared disaster. In this situation, the NOL can be carried back three years, so that the entire $66,000 NOL can be absorbed in 1995, the first year to which the NOL can be carried.

PRACTICAL ANALYSIS. Stuart J. Offer, of Morrison & Foerster, San Francisco, Calif., notes that as initially proposed by President Clinton, the carryback of net operating losses would have been limited to one year, as opposed to the three-year carryback period provided by pre-'97 Act law. Under the legislation as adopted, the carryback period will be limited to two years, so the new law is only half as bad (or twice as good) as originally proposed.

For many companies, the inability to obtain a refund of taxes paid during the three-year carryback period of pre-'97 Act law will be a real financial hardship. Since the new law is first effective for tax years beginning after the date of enactment, Mr. Offer notes that calendar-year taxpayers who could time loss recognition would be well advised to realize losses in the current year in order to obtain refunds of 1995 taxes, since the 1995 year will not be available for loss carryback in 1998.

The extension of the carryforward period from 15 years to 20 years is unlikely to provide significant benefit to taxpayers. The present value of the future deductions in years 15 through 20 is marginal under any reasonable discount. Moreover, it is likely that before the 20-year period expires, there will be one or more ownership changes which will impose limits on the loss carryforward under Code Sec. 382.

Effective date. The provision is effective for NOLs for tax years beginning after August 5, 1997. The provision does not apply to NOLs carried forward from prior tax years.

Act Sec. 1082(a), amending Code Sec. 172(b)(1)(A); Act Sec. 1082(b), adding Code Sec. 172(b)(1)(F); Act Sec. 1082(c). Law at ¶ 5079. Committee Report at ¶ 11,520.

TAX CREDITS

Research Credit

¶ 317

Background

Taxpayers are entitled to a research tax credit that generally equals 20 percent of the amount by which research expenditures exceed a base amount. The credit was originally enacted in 1981 and has been modified and extended repeatedly. The credit was last extended by the Small Business Job Protection Act of 1996 (P.L. 104-188) for 11 months. It expired for amounts paid or incurred after May 31, 1997.

The Small Business Act gave taxpayers the option of electing an alternative incremental research credit. Under the alternative method, the taxpayer calculates the amount of the credit under a three-tiered regime that uses reduced credit rates and base amounts. The alternative method can generate higher research credits for companies with dramatically increasing sales figures or stagnant research expenditures. If the taxpayer elected the alternative incremental credit regime for its first tax year beginning after June 30, 1996 (and before July 31, 1997), then all research expenditures paid or incurred during the first 11 months of the tax year are treated as research expenses for purposes of computing the research credit.

Research credit extended through June 30, 1998.—The research tax credit has been retroactively extended, for the period from June 1, 1997 through June 30, 1998.

Taxpayers may elect the Code Sec. 41(c)(4) alternative incremental research credit (enacted by the Small Business Job Protection Act of 1996, P.L. 104-188,

which last extended the research credit for 11 months), for any tax year beginning after June 30, 1996. The election will apply to the tax year in which the election is made, and to all subsequent tax years. The election may be revoked only with IRS consent.

Alternative incremental credit. Although the new law schedules the research credit to expire on June 30, 1998, if a taxpayer elects the alternative incremental research credit for its first tax year beginning after June 30, 1996, and before July 1, 1997, the alternative credit will be available for the entire 24-month period beginning with that tax year. This period equals the 11-month research credit extension enacted by the Small Business Job Protection Act of 1996, plus the 13-month extension granted by this Act. However, to prevent taxpayers from taking more than the 24 months of credits enacted by the '96 Act and this Act combined, the 24-month period a taxpayer may claim the alternative incremental credit is shortened by the number of months after June 1996 for which the taxpayer claimed the regular 20-percent research credit.

Effective date. This provision is effective for amounts paid or incurred after May 31, 1997.

Act Sec. 601(a), amending Code Sec. 41(h)(1); Act Sec. 601(b), amending Code Sec. 41(c)(4)(B) and 45C(b)(1); Act Sec. 601(c). Law at ¶ 5019 and 5021. Committee Report at ¶ 10,435.

Work Opportunity Credit

¶ 318

Background

An employer who hires an individual from one of seven targeted groups may elect to take a credit for 35 percent of the employee's qualified first-year wages. Generally, the maximum amount of first-year wages (with respect to any individual) that are eligible for the credit is $6,000; thus, the maximum credit per employee is $2,100. No credit is allowed unless the worker is employed by the employer for a minimum of 180 days or completes 400 hours of service. Prior to the Taxpayer Relief Act of 1997, the credit was scheduled to expire for wages paid to employees who began work after September 30, 1997.

One of the targeted groups is defined as members of families receiving aid to families with dependent children (AFDC). In order to be an eligible employee in the AFDC family targeted group, the individual must be a member of a family eligible to receive AFDC benefits for a nine-month period ending during the nine-month period ending on the hiring date.

Work opportunity credit extended through June 30, 1998.—The work opportunity credit has been extended for nine months and is now scheduled to expire for wages paid to people who begin work for a taxpayer after June 30, 1998. Under prior law, the provision was scheduled to expire for individuals beginning work after September 30, 1997.

Two-tiered credit. Employers of targeted group members are now entitled to a credit of 40 percent (increased from 35 percent) of the qualified first-year wages. The percentage is reduced to 25 percent in the case of wages attributable to individuals meeting only minimum employment levels. In order for an employee's wages to be eligible for the work opportunity credit, the employee must have completed a minimum of 120 hours of service. The hours of service test is the only

way the minimum employment period is measured for work opportunity credit purposes; the minimum service requirement can no longer be satisfied by an employee being employed for at least 180 days.

Assuming the employee meets the 120-hour minimum service requirement, the employer is entitled to a credit of 25 percent if an employee performs less than 400 hours of service for the employer. For employees performing 400 or more hours of service, the applicable credit percentage is 40 percent of the employee's wages. Under prior law, a 35-percent credit was allowed after an employee completed 400 hours of service or was employed at least 180 days.

Amendments to targeted groups. A new group has been added to the existing seven targeted groups. The new targeted group is composed of persons certified by a designated local agency as receiving certain Supplemental Security Income (SSI) benefits for any month ending within the 60-day period ending on the hiring date. SSI benefits for purposes of this provision include benefits under Title XVI of the Social Security Act (including supplemental security income benefits of the type described in section 1616 of such act or section 212 of Public Law 93-66).

The "IV-A recipient" targeted group (aid to families with dependent children or AFDC families targeted group) has been amended. A person is considered a member of the AFDC families targeted group, if for any nine months (consecutive or nonconsecutive) during the 18-month period ending on the hiring date, the person qualifies as a member of the AFDC families targeted group (regardless of whether that person is a veteran). The 18-month period is twice as long as the nine-month period provided under prior law.

Effective date. The amended rules apply to individuals who begin work for the employer after September 30, 1997.

Act Sec. 603(a), amending Code Sec. 51(c)(4)(B); Act Sec. 603(b), amending Code Sec. 51(d)(2)(A) and 51(d)(3)(A); Act Sec. 603(c), adding Code Sec. 51(d)(1)(H), redesignating Code Sec. 51(d)(9), 51(d)(10) and 51(d)(11) as Code Sec. 51(d)(10), 51(d)(11) and 51(d)(12), and adding new Code Sec. 51(d)(9); Act Sec. 603(d), amending Code Sec. 51(a) and 51(i)(3); Act Sec. 603(e). Law at ¶ 5023. Committee Report at ¶ 10,445.

Orphan Drug Credit

¶ 319

Background

A 50-percent tax credit is available for qualified clinical testing expenses incurred in testing certain drugs for rare diseases or conditions. Prior to the Taxpayer Relief Act of 1997, the enabling Code section included a sunset provision under which the orphan drug credit periodically expired and had to be reinstated by an act of Congress.

Orphan drug credit made permanent.—The orphan drug credit has been made permanent, and will no longer need to be extended periodically. The credit last expired on May 31, 1997, but has been retroactively reinstated.

Effective date. The extension of the credit is effective for qualified clinical testing expenses paid or incurred after May 31, 1997.

Act Sec. 604(a), striking Code Sec. 45C(e); Act Sec. 604(b). Law at ¶ 5021. Committee Report at ¶ 10,450.

Welfare-to-Work Credit

¶ 320

Background

The work opportunity tax credit may be elected by employers that hire individuals from any of seven targeted groups, including members of families receiving Aid to Families with Dependent Children (AFDC). The amount of the credit is 35 percent of the qualified wages for the tax year. "Qualified" wages are those paid or incurred by the employer during the year with respect to an individual who was a member of one of the targeted groups. Prior to the Taxpayer Relief Act of 1997, only first-year wages could be deducted. First-year wages are those paid during the one-year period beginning with the day the individual begins work with the employer.

New credit for hiring long-term family assistance recipients.—A new credit, called the welfare-to-work credit, is available for employers for wages paid to long-term family assistance recipients who begin work after 1997. The amount of the credit for a tax year is 35 percent of the qualified first-year wages for such year plus 50 percent of the qualified second-year wages for such year. The credit applies only to the first $10,000 of wages in each year with respect to any individual. Thus, the maximum total credit per qualified employee is $8,500 for the two years.

Wages. The term "wages" is given a broad meaning for purposes of the welfare-to-work credit. In addition to remuneration for employment and the value of certain benefits provided, it includes the following amounts paid or incurred by the employer and excludable from the recipient's income as:

(1) amounts received under accident and health plans (Code Sec. 105);

(2) contributions by employers to accident and health plans (Code Sec. 106);

(3) educational assistance under a Code Sec. 127 program or that would be excludable if not for the expiration of Code Sec. 127; and

(4) dependent care expenses (Code Sec. 129).

The amount treated as wages under (1) or (2) above is limited to the applicable premium amount for health care continuation coverage for the period under Code Sec. 4980B(f)(4). Educational assistance provided by the employer to a related person may not be counted as wages.

In the case of agricultural or railroad workers, wage rules similar to those in Code Sec. 51(h) are applicable, but $10,000 is substituted for $6,000 in the provision on agricultural workers and $833.33 for $500 in the provision on railroad workers.

Qualified first-year and second-year wages. "Qualified" wages are wages paid or incurred by the employer during the tax year to individuals who are long-term family assistance recipients. "Qualified first-year wages" are qualified wages attributable to service rendered by the individual during the one-year period beginning with the day such individual began work for the employer. "Qualified second-year wages" are qualified wages attributable to service rendered during the one-year period beginning on the day after the last day of the period for determining first-year wages.

Long-term family assistance recipients. There are three categories of persons who qualify as long-term family assistance recipients:

(1) members of a family that has been receiving family assistance for at least the 18-month period ending on the hiring date;

(2) members of a family that receives family assistance for at least 18 months beginning after August 5, 1997 of the credit and who have a hiring date not more than two years after the 18-month total is reached; and

(3) members of a family that, after August 5, 1997, are no longer eligible for family assistance because of a limitation imposed under either federal or state law on the maximum duration such assistance is payable and who have a hiring date not more than two years after such eligibility expires.

Caution. In applying the above rules, however, note that the welfare-to-work credit does not apply to individuals who begin work for the employer after April 30, 1999.

For purposes of these rules, a long-term family assistance recipient is a person who is certified by the designated local agency as being a member of a family receiving assistance under a IV-A program (i.e., a program providing aid under Part A of Title IV of the Social Security Act). The term "hiring date" has the meaning given to that term under Code Sec. 51(d), which is the day the individual is hired by the employer.

Coordination with other Code provisions. Rules similar to the special rules of Code Sec. 52 and the provisions in Code Sec. 51 on the election to have the work opportunity credit not apply (Code Sec. 51(j)) and the treatment of successor employers and employees working for another employer (Code Sec. 51(k)) apply to the welfare-to-work credit. In addition, the Code Sec. 51 provisions on certifications (Code Sec. 51(d)(11)), the trade or business employment requirement (Code Sec. 51(f)), notification to employers by the U.S. Employment Service (Code Sec. 51(g)), and ineligible individuals (Code Sec. 51(i)) are applicable as in effect on the day before the enactment of the Taxpayer Relief Act of 1997.

The welfare-to-work credit is deemed to be part of the general business credit, and references to Code Sec. 51 in Code Secs. 38(b) (current year business credit), 280C (certain expenses for which credits are allowable), and 1396(c)(3) (empowerment zone employment credit) are treated as including references to the welfare-to-work credit. If a welfare-to-work credit is allowed to an employer with respect to an individual for any tax year, the individual is not treated as a member of a targeted group for such tax year for purposes of the Code Sec. 51 work opportunity credit.

PRACTICAL ANALYSIS. Professor Karen Kole of the University of Tulsa School of Law notes that the welfare-to-work credit is basically an incentive for businesses to employ long-term family assistance recipients. Unfortunately, the amount of wages that will qualify is limited to $10,000 per year and then for only a two-year period. The term "long-term family assistance recipient" means any individual who is certified by the designated local agency as being a member of a family receiving assistance under a public aid program for at least the 18-month period ending on the hiring date. It would appear that these provisions are again so detailed and administratively burdensome to an employer that only the larger employers will be willing to work with this provi-

sion from a cost/benefit standpoint. Smaller employers (the backbone of the U.S. economy and the group that would be in the most likely position to hire long-term family assistance recipients) will most likely find the provision too difficult to administer to make it worthwhile, given the amount of the credit the employer would receive.

Effective date. This provision applies to individuals who begin work for their employer after December 31, 1997.

Act Sec. 801(a), adding Code Sec. 51A; Act Sec. 801(b) and (c). Law at ¶ 5025. Committee Report at ¶ 10,485.

General Business Credit Carryover Periods

¶ 321

Background

Before the Taxpayer Relief Act of 1997, a taxpayer was required to use a three-year carryback and a 15-year carryforward period when the current year's general business credit exceeded the allowable limit. This rule still applies for credits that arose in tax years beginning before January 1, 1998.

New time period for carryback and carryforward of unused general credit.—Taxpayers are now required to use a *one-year* carryback and a *20-year* carryforward period when the current year's general business credit exceeds the maximum limit. This time period replaces the three-year and 15-year period.

Planning Note. The change means that a taxpayer that is unable to use the full amount of the current year's general business credit, will have a total of *21* carryback and carryforward years in which to claim the remaining credit. Under prior law, the total carryback and carryforward period was 18 years. The change may offer some administrative convenience for the taxpayer and the IRS due to the fact that there is only a need for one amended tax return because only one carryback year is involved.

> **Example.** In 1998, Rapport Inc. had a general business credit of $5,000. The corporation was able to use $1,000 of the credit against its federal income tax liability. Rapport is required to carryback the $4,000 unused credit to offset against its 1997 federal income liability. Any remaining credit would then be applied against Rapport's income tax liability for the years 1999 through 2018.

Planning Note. The carryback and carryforward periods have only been changed for credits that arise in tax years that begin after December 31 1997. Thus, credits that arose in tax years that began before that date are still subject to the three-year and 15-year time limits.

Effective date. The change applies to credits that arise in tax years beginning after December 31, 1997.

Act Sec. 1083(a), amending Code Sec. 39(a)(1) and (2); Act Sec. 1083(b). Law at ¶ 5017. Committee Report at ¶ 11,525.

EXCLUSIONS

Lessee Construction Allowance

¶ 322

Background

The Internal Revenue Code did not specify whether cash payments or rent reductions made by a retail lessor to its lessee for the purpose of making improvements or additions were treated as part of the lessee's gross income. The IRS position, outlined in an October 7, 1996 coordinated issue paper, was that the inducement payments were accessions to wealth except to the extent that the lessor benefited from the improvements. Ownership for federal tax purposes, the IRS said, was determined by applying the "benefits and burdens of ownership" test to the particular transaction.

Conversely, the law did specify that the lessor's gross income does not include income, other than rent, derived from the property on the termination of a lease. Thus, the value of any improvements made by the lessee, including the erection of buildings, is not included in the lessor's gross income.

Construction allowances for retail space additions and improvements.—The Act provides that a retail tenant that receives cash or rent reductions from the lessor of the retail space does not include that amount in gross income if it is used for qualified construction or improvement to the space. The tenant must have a short-term lease on the retail space, and the construction or improvement must be on qualified long-term real property that is used in the tenant's trade or business at the retail space. The amount excluded from gross income must not exceed the amount expended by the tenant for the construction or improvement.

Qualified long-term real property. "Qualified long-term real property" is nonresidential real property that is part of, or present at, the retail space. The property must revert to the lessor at the termination of the lease.

Disposed or abandoned property. Qualified long-term real property constructed or improved for the use of a retail lessee is treated as the lessor's nonresidential real property. Consequently, a construction or an improvement that is irrevocably disposed of or abandoned by the lessor at the time the lessee terminates the lease is treated, for purposes of determining gain or loss, as being disposed of or abandoned by the lessor at the time of disposal or abandonment.

Short-term lease. A "short-term lease" is a lease, or other agreement for occupancy or use of retail space, that has a duration of 15 years or less.

Retail space. "Retail space" is real property leased, occupied or otherwise used by the tenant for the sale of tangible personal property or services to the general public.

Reporting requirements. At a time and manner specified by federal regulations, the lessor and the tenant must provide information to the IRS concerning the amount of cash received or of the rent reduction provided for construction and improvements. The IRS also may promulgate regulations requesting additional information.

Effective date. These provisions apply to leases entered into after August 5, 1997.

Act Sec. 1213(a), adding new Code Sec. 110; Act Sec. 1213(b), amending Code Sec. 6724(d)(1)(A); Act Sec. 1213(c), amending Code Sec. 168(i)(8); Act Sec. 1213(d); Act Sec. 1213(e). Law at ¶ 5047, 5075, and 5711. Committee Report at ¶ 12,175.

DEPRECIATION AND DEPLETION

Income Forecast Depreciation Method

¶ 325

Background

Taxpayers seeking to recover the cost of trade or business property that is not eligible for depreciation under the modified accelerated cost recovery system or that does not qualify as intangible property under Code Sec. 197 may be able to depreciate such property under the income forecast method. Under this method, the depreciation deduction is determined not by reference to a term of years but by multiplying the cost of the property, less any salvage value, by a fraction, the numerator of which is the income generated by the property during the tax year and the denominator of which is the total estimated income to be derived from the property during its useful life.

Under prior law, controversy existed over the types of property that were depreciable under the income forecast method. In a series of rulings, the IRS approved the use of the income forecast method for television and motion picture films, videotapes, sound recordings, book manuscript rights, patents, master recordings, and other property of similar character. In 1995, the IRS issued a ruling (Rev. Rul. 95-52, 1995-2 CB 27) denying application of the income forecast method to consumer goods leased under rent-to-own contracts. It drew a sharp distinction between assets of an artistic or creative character that generate uneven flows of income, for which the income forecast method was suitable, and assets such as consumer durable property (whether or not subject to a rent-to-own contract) having a useful life appropriately measured by the passage of time and not by the income produced.

Subsequently, the U.S. Court of Appeals for the 10th Circuit refused to limit the income forecast method to movies and similar assets that can be depreciated only under a method not expressed in a term of years (*ABC Rentals of San Antonio,* CA-10, 1996-2 USTC ¶ 50,508). It determined that Code Secs. 167 and 168 allowed for depreciation under the income forecast method even when the asset had a discernible useful life. The key factor was not the type of asset, but whether using a depreciation method not expressed in a term of years would provide a reasonable and consistent means of allocating an asset's cost to the years of its contribution.

Use of income forecast method limited.—The income forecast method of depreciating trade or business assets is limited by new law to film, video tape, sound recordings, copyrights, books, patents, and other property to be specified by regulations. The controlling committee report directs that the regulations restrict the use of the income forecast method to instances when the economic depreciation of the property cannot be adequately reflected solely by the passage of time or when the income stream from the property is sufficiently unpredictable or uneven so that the application of another method of depreciation would result in a

distortion of income. The income forecast method is not available to intangible property amortizable under Code Sec. 197.

Consumer durable property subject to rent-to-own contracts. The income forecast method cannot be used to calculate the depreciation of consumer durables subject to rent-to-own contracts. Rather, qualified rent-to-own property is subject to depreciation under the modified accelerated cost recovery system (MACRS) and over a three-year recovery period with a four-year class life.

Qualified rent-to-own property and dealers. Qualified rent-to-own property is property held by a qualified rent-to-own dealer for purposes of being subject to rent-to-own contracts. A qualified rent-to-own dealer is a person who, in the regular course of business, provides customers with consumer property subject to the terms of a rent-to-own contract, but only where a substantial portion of those contracts terminate resulting in the return of the goods before the receipt of all payments required to transfer ownership of the property from the dealer to the customer. Consumer property is tangible personal property generally used in the home, such as televisions, camcorders, stereos and furniture.

Dual-use property. Property such as cellular phones and computer equipment, which could be used for both personal and business purposes, may also be considered qualified rent-to-own property. However, in order to qualify, such dual-use property must not represent a significant portion of a dealer's leasing property and the other property leased must be qualified rent-to-own property.

Caution. Rent-to-own dealers for whom dual-use property constitutes a significant portion of their leasing inventory will bear the burden of proving that their dual-use property is qualified rent-to-own property.

Rent-to-own contract. A rent-to-own contract is a lease for the use of consumer property between a rent-to-own dealer and an individual customer. The contract must be titled "Rent-to-Own Agreement" or "Lease Agreement with Ownership Option" or use other similar language. It must provide for a weekly or monthly payment period and a payment rate that in the aggregate generally exceeds the normal retail price of the property plus interest, but in no case may the aggregate payments exceed $10,000 per item. Payments may be level or decreasing, but may be decreasing only where no payment is less than 40 percent of the largest payment. The contract must specify the terms under which title to the property transfers from the dealer to the individual, and the duration of the lease may not exceed 156 weeks or 36 months. Further, the contract must state that the customer has no legal obligation to make all payments set forth under the contract and that, at the end of each weekly or monthly payment interval, the customer may return the property to the rent-to-own dealer in good working order and be free of any further obligations. Also, under the contract, the customer has no right to a return of previously made payments and has no right to sell, sublease, mortgage, pawn or otherwise dispose of the property until all contract payments have been made.

Effective date. The provision applies to property placed in service after August 5, 1997.

Act Sec. 1086(a), adding Code Sec. 167(g)(6); Act Sec. 1086(b)(1), amending Code Sec. 168(e)(3)(A); Act Sec. 1086(b)(2), amending 168(g)(3)(B); Act Sec. 1086(b)(3), adding Code Sec. 168(i)(14); Act Sec. 1086(c). Law at ¶ 5073 and 5075. Committee Report at ¶ 11,540.

Percentage Depletion for Marginal Production

¶ 326

Background

Percentage depletion deductions with respect to oil and gas wells may not exceed 65 percent of the taxpayer's taxable income or 100 percent of the taxpayer's net income from the property. For this purpose, taxable income is computed without taking into account depletion allowances. Under prior law, no exception to the taxable income limitation was provided for oil and gas production from marginal properties. A marginal property is a domestic stripper well or domestic property, substantially all of the production of which is heavy oil.

Taxable income limit temporarily suspended.—The 100-percent taxable income limit on percentage depletion deductions for oil and gas properties has been temporarily suspended for marginal properties for tax years beginning after December 31, 1997, and before January 1, 2000. Thus, during the suspension period, the amount of percentage depletion deductions that may be claimed with respect to marginal production is not limited to 100 percent of the taxpayer's taxable income from the property (computed without allowances for depletion). Marginal production is crude oil or natural gas that is produced from a domestic stripper well or from domestic property, substantially all of the production of which is heavy oil.

Effective date. This provision applies to tax years beginning after December 31, 1997.

Act Sec. 972(a), adding Code Sec. 613A(c)(6)(H); Act Sec. 972(b). Law at ¶ 5191. Committee Report at ¶ 10,890.

Clean Fuel Vehicles

¶ 327

Background

Under Code Sec. 280F, the amount allowed as a depreciation deduction for "luxury" automobiles is limited to the following base amounts: $2,560 for the first tax year in the recovery period, $4,100 for the second year, $2,450 for the third year, and $1,475 for each additional year in the recovery period. These amounts are adjusted for inflation annually. Under prior law, the same limitations applied to electric and clean-burning fuel vehicles. Thus, the maximum deductible amounts were not adjusted to account for the extra cost of such vehicles.

Exemption of the incremental cost of a clean fuel vehicle from the limits on depreciation for vehicles.—The Code Sec. 280F limitations on depreciation for "luxury" automobiles have been modified for electric vehicles and automobiles that have been equipped to qualify as clean-burning fuel vehicles.

For electric passenger vehicles built by an original equipment manufacturer, the base year limitations on depreciation have been tripled to $7,680 for the first tax year in the recovery period, $12,300 for the second year, $7,350 for the third year, and $4,425 for the fourth year. These figures are subject to adjustment for inflation.

For passenger vehicles that initially used nonclean-burning fuel, but were modified to allow them to be propelled by clean-burning fuel, the Code Sec. 280F

limitations do not apply to the cost of the installed device that equips the car to use clean-burning fuel. The rest of the vehicle's cost remains subject to the Code Sec. 280F limitations.

Effective date. This provision is effective for property placed in service after August 5, 1997 and before January 1, 2005.

Act Sec. 971(a), adding Code Sec. 280F(a)(1)(C); Act Sec. 971(b). Law at ¶ 5109. Committee Report at ¶ 10,885.

Definition of Indian Reservation

¶ 328

Background

Property located on Indian reservations may be eligible for accelerated depreciation under Code Sec. 168(j)(6). An "Indian reservation" is defined as a reservation under (1) section 3(d) of the Indian Financing Act of 1974 (25 U.S.C. 1452(d)) or (2) section 4(10) of the Indian Child Welfare Act of 1978 (25 U.S.C. 1903(10)). The Indian Financing Act of 1974 includes all "former Indian reservations in Oklahoma." For historic reasons, this includes most of Oklahoma.

The Code Sec. 45A incremental Indian employment credit also uses the Code Sec. 168(j)(6) definition of "Indian reservation."

Definition of Indian reservation clarified for purposes of depreciation and credit.—The definition of "Indian reservation," for purposes of the incremental Indian employment credit under Code Sec. 45A and the accelerated depreciation allowed under Code Sec. 168(j), has been clarified. "Former Indian reservations in Oklahoma," as defined in section 3(d) of the Indian Financing Act of 1974, only includes lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior and (2) recognized by the Secretary as eligible for trust land status under 25 CFR Part 151.

Effective date. The clarification generally applies to property placed in service and wages paid after December 31, 1993. However, the provision does not apply to wages for which the taxpayer claimed the benefit of the Code Sec. 45A incremental Indian employment credit on any original return filed prior to March 18, 1997. The provision also does not apply to property placed in service with a 10-year or less life (without regard to Code Sec. 168(j) which provides for a six-year recovery period), if accelerated depreciation under Code Sec. 168(j), was claimed with respect to the property on an original return filed prior to March 18, 1997.

Act Sec. 1604(c)(1), amending Code Sec. 168(j)(6); Act Sec. 1604(c)(2). Law at ¶ 5075. Committee Report at ¶ 13,940.

DEDUCTIONS

Environmental Cleanup Costs

¶ 330

Background

Under prior law, the answer to the question of whether environmental cleanup costs should be classified as currently deductible expenses or capital expenditures

Background

was subject to a great deal of uncertainty. Although the IRS addressed the question in Revenue Ruling 94-38 (1994-1 CB 35) and several Technical Advice Memoranda, these pronouncements did not provide much in the way of universal guidance and their holdings were only relevant in certain narrow fact situations. Thus, even after the IRS had issued several determinations on the subject, there were still no clear-cut guidelines concerning the tax treatment of environmental cleanup costs.

Certain environmental cleanup costs are currently deductible.—A taxpayer may elect to currently deduct costs paid or incurred for the cleanup (i.e., remediation) of certain hazardous substances. If the taxpayer does not make the expense election, the costs are classified as capital costs. This election will not be available for expenses paid or incurred after December 31, 2000.

Planning Note. Property that has been contaminated by hazardous substances has come to be called "brownfields." Thus, this new provision is sometimes referred to as the "brownfields amendment" or the "brownfields rule."

Qualified cleanup costs. In order to be a qualified cleanup cost the expense must be:

(1) an expense that would otherwise be charged to a capital account; and

(2) paid or incurred in connection with the abatement or control of "hazardous substances" at a "qualified contaminated site."

Planning Note. If the cleanup expense does not satisfy the definitions of "hazardous substances" and "qualified contamination site" (see below), then the taxpayer is not eligible to elect current deduction.

Caution. The legislative history of this provision makes clear that it does not create any inference concerning the proper tax treatment of environmental cleanup expenses that are not described under the new rules.

Depreciable property. As a general rule, the term "qualified cleanup costs" does not include the cost of depreciable property that is used in connection with qualified cleanup activities. However, the otherwise allowable depreciation deduction for such depreciable property that is allocable to the contaminated site does qualify as a cleanup expense.

Caution. According to the legislative history of this provision, depreciation deductions will qualify as cleanup expenses if the expenses would be allocable to the contaminated site under the principals of *Idaho Power Co.* (SupCt, 74-2 USTC ¶ 9521), and the uniform capitalization rules of Code Sec. 263A. Thus, the legislative history adds more detail than that contained in the new Code provision. It is likely that when the IRS drafts regulations for this provision that it will incorporate the requirements mentioned in the legislative history.

> **Example (1).** In 1998, Advet Inc. purchased equipment that will be used in part for the remediation of contaminated land that it recently purchased for use in its business operations. When the equipment is not being used on the remediation project, it will be used for other business activities of the corporation. The portion of the cost of the equipment that would otherwise be allocated to the basis of the land under the holding in *Idaho Power Co.* will be classified as a deductible cleanup expense of Advet Inc. The remaining

portion of the cost of the equipment would be depreciated under the MACRS provisions.

Qualified contaminated site. The term "qualified contaminated site" refers to any area:

(1) that is held by the taxpayer for use in a trade or business, for the production of income, or as a stock in trade or inventory;

(2) that is within a "targeted area"; and

(3) at or on which there has been a release (or threat of release) or disposal of any hazardous substance.

Caution. In order to satisfy requirements (2) and (3) above (i.e., "targeted area" and "hazardous substance"), the taxpayer must obtain a statement from the state's environmental agency. The chief executive officer of a state may consult with the Administrator of the Environmental Protection Agency (EPA), and designate the appropriate state environmental agency within 60 days after enactment of this new provision. If the chief officer of the state has not designated the appropriate state agency within this 60-day period, the EPA will designate the appropriate state agency.

Planning Note. It is very important to note that the cleanup deduction not only applies to trade and business property, and property held for the production of income, but also property *held as stock in trade or inventory.*

Example (2). Cleanco is a partnership involved in the business of buying and selling undeveloped land. In 1998, the partnership purchased a 40 acre parcel that was contaminated by a hazardous substance. During the year, Cleanco spent $75,000 in cleaning up the site. Cleanco may either elect to add the $75,000 cost to its basis in the land or it may elect to expense the $75,000 as a deduction for cleanup expenses.

Targeted area defined. In order to make the cleanup election, the contaminated site must be in a targeted area. The term "targeted area" is generally defined as:

(1) any population census tract with a poverty rate of at least 20 percent;

(2) a population census tract with a population of less than 2,000 if more than 75 percent of the tract is zoned for commercial or industrial use, and the tract is contiguous to one or more other population census tracts that have a poverty rate of at least 20 percent;

(3) any empowerment zone or enterprise community (and any supplemental zone designated on December 21, 1994); and

(4) any site announced before February 1, 1997, as being part of the brownfields pilot project of the EPA.

Caution. A "targeted area" does not include any site on, or proposed to be on, the National Priorities List (NPL). The NPL is a listed of contaminated sites that is issued by the President and revised at least on a yearly basis.

Planning Note. The 20 additional empowerment zones authorized by this legislation, as well as the D.C. Enterprise Zone are "targeted areas" for purposes of the environmental cleanup rules.

Hazardous substance. The new provision defines the term "hazardous substance" by referring to the definition contained in the Comprehensive Environmen-

tal Response, Compensation, and Liability Act of 1980 (CERCLA). In turn, this 1980 Act refers to the definition contained in various other pieces of federal legislation. Generally, the term generally includes toxic pollutants and hazardous chemical wastes.

Planning Note. The legislative history of the election provision makes clear that asbestos and similar substances within buildings, certain natural substances (e.g., radon) and other substances released into drinking water due to deterioration through ordinary use, are considered to be hazardous substances.

Deduction is recaptured. Any cost expensed under the cleanup election that, but for this expense election, would have been capitalized is subject to recapture as ordinary income when the property that was contaminated is sold or otherwise disposed of.

Planning Note. In effect, the amount expensed as a cleanup cost is treated as depreciation on Section 1245 property. Thus, when the property is sold, gain to the extent of the cleanup cost deduction is treated as ordinary income.

> **Example (3).** In 1998, Sam Waters purchased an acre of land that was contaminated with a hazardous substance. The land cost $1,000 and Sam spent $50,000 in remediation expenses. He elected to claim a current deduction for the $50,000 instead of adding it to his basis in the land. Several years later he sold the land for $60,000. He would be required to treat $50,000 of his gain as ordinary income.

Demolition of structures. The election to expense cleanup costs *does not* extend to costs incurred in the demolition of structures.

Planning Note. When taxpayers demolish structures that they own, the cost of demolition and/or the any loss sustained because of the demolition may not be deducted. Instead, the cost and/or loss is reflected in the basis of the property. The new provision specifically prevents converting demolition cost and/or loss into a deductible cleanup cost.

> **Example (4).** In 1998, Jane Croft purchased land upon which an abandoned gas station is located. The land will be used for the production of income. Croft determines that the land and the foundation of the building are contaminated with hazardous substances. She spends $5,000 to have the building torn down and $100,000 for the necessary remediation of the soil. Croft may elect to deduct the $100,000 in cleanup expenses. However, the $5,000 in demolition expenses must be added to her basis in the property.

Mining and solid waste reclamation. In certain circumstances, taxpayers are permitted to claim an advance deduction for the costs that they will incur for certain reclamation and closing costs associated with mines and solid waste disposal properties. The new provision concerning cleanup costs *does not* extend to these mining and solid waste reclamation costs.

Effective date. This provision applies to expenditures paid or incurred after August 5, 1997, in tax years ending after that date.

Act Sec. 941(a), adding new Code Sec. 198; Act Sec. 941(b) and (c). Law at ¶ 5081. Committee Report at ¶ 10,715.

Meals Provided for Employer's Convenience

¶ 332

Background

Under current law, only 50 percent of business meal and entertainment expenses are allowed as a business expense deduction. Until the Taxpayer Relief Act of 1997, no specific statutory provision exempted meals that are provided for the convenience of the employer from the 50-percent limit, even though the cost of these meals are fully excludable from an employee's income under Code Sec. 119.

Employers' deduction for meals provided for convenience of employer.—Meals that are excluded from an employee's income under Code Sec. 119, which deals with meals provided on the employer's premises for the convenience of the employer, are now considered a *de minimis* fringe benefit under Code Sec. 132. Therefore, meals that are provided at an eating facility for employees are fully deductible by the employer, instead of possibly being subject to the 50-percent limit on deductibility of business meal expenses under Code Sec. 274. For this purpose, the employee is treated as having paid an amount for the meal equal to the direct operating costs of the facility attributable to the meal.

Effective date. The provision is effective for tax years beginning after December 31, 1997.

Act Sec. 970(a), amending Code Sec. 132(e)(2); Act Sec. 970(b). Law at ¶ 5055. Committee Report at ¶ 10,880.

INVOLUNTARY CONVERSIONS AND LIKE-KIND EXCHANGES

Replacement Property from Unrelated Persons

¶ 334

Background

Gain realized by a taxpayer from certain involuntary conversions of property is deferred to the extent that the taxpayer purchases property similar or related in service or use to the converted property within a specified replacement period, which generally begins on the earlier of the date of disposition or the earliest date of the threat or imminence of requisition or condemnation of the converted property and ends two years after the close of the first tax year in which any part of the gain from conversion is realized. The Self-Employed Health Insurance Act (P.L. 104-7) banned C corporations and certain partnerships with corporate partners from using the involuntary conversion gain deferral rules if the replacement property or stock was purchased from a related person, but this ban did not apply to other noncorporate taxpayers. An exception to this related-party rule was provided when the related party had itself acquired the replacement property or stock from an unrelated person within the replacement period.

Expansion of ban on related party acquisition of replacement property.—The ban on the acquisition of involuntary conversion replacement property from related parties that applies to C corporations and certain partnerships with C corporation partners is extended to apply to all other taxpayers (including individuals) who do not meet the $100,000 *de minimis* exception (see below). Such taxpayers generally cannot defer the recognition of gain from the involuntary

conversion of property if the replacement property or stock has been purchased from a related party (as defined in Code Sec. 267(b) or 707(b)(1)) unless the related party acquired the replacement property or stock from an unrelated party during the statutorily provided replacement period. The statutorily provided replacement period generally begins on the earlier of the date of disposition, or the earliest date of the threat or imminence of requisition or condemnation of the converted property and ends two years after the close of the first tax year in which any part of the gain from conversion is realized.

De minimis *exception.* A $100,000 *de minimis* exception applies to the rule requiring gain recognition on involuntarily converted property where replacement property is acquired from a related person. The gain realized from such an involuntary conversion can be deferred by taxpayers (other than C corporations and certain partnerships with majority corporate partners) if the aggregate of the amount of realized gain on the property, on which there is a realized gain, is $100,000 or less. In the case of a partnership or S corporation, the $100,000 limitation would apply to both the partnership and each partner and to both the S corporation and each shareholder.

Caution. Although a separate application of the $100,000 limitation to partnerships and their partners has been prescribed, such rule will not affect a partnership or the partners of a partnership in which one or more C corporations own more than 50-percent capital or profits interest in the partnership at the time of the involuntary conversion since such a partnership cannot avail itself of the $100,000 *de minimis* exception in any event.

Effective date. These provisions apply to involuntary conversions occurring after June 8, 1997.

Act Sec. 1087(a), amending Code Sec. 1033(i); Act Sec. 1087(b). Law at ¶ 5321. Committee Report at ¶ 11,545.

Foreign Replacement Property

¶ 336

Background

Real property is generally treated as like-kind with other real property under Code Sec. 1031 as long as both properties are located either within or outside of the United States. No such requirement applied to personal property prior to the Taxpayer Relief Act of 1997.

Foreign and U.S. personal property not like-kind property.—As is currently the case with real property, personal property must now be similar in location of use to be treated as like-kind property for purposes of the Code Sec. 1031 like-kind exchange gain deferral rules. Thus, personal property predominantly used in the United States and personal property predominantly used outside of the United States are not "like-kind" property, even if (1) the exchanged properties are of a "like class," (2) the like-kind exchange gain deferral rules apply to that type of property (i.e., the properties exchanged are not stocks or bonds, inventory, or similar property), and (3) the exchange meets the other requirements of the like-kind exchange rules.

Property described in Code Sec. 168(g)(4) that is used both within and outside of the United States, but which is eligible for accelerated depreciation as if used in the United States, is classified as property predominately used in the United States

for the like-kind exchange rules. The predominant use of property surrendered in the exchange is determined based on the use of the property in the two-year period ending on the date the property is relinquished. The predominant use of property acquired in the exchange is based on its use during the two-year period beginning on the date of acquisition.

> **Example.** On August 1, 1997, Johnston, Inc. relinquished a computer solely used in the U.S. in exchange for a computer that was also solely used in the U.S. Within 20 months after the exchange, Johnston, Inc. will transfer its manufacturing operations to an Eastern European country, and the computer will be one of the assets transferred in the move. As the House Committee Report noted, for Code Sec. 1031 to apply, the property received in the exchange must continue in the same use, either foreign or domestic, for the two-year period immediately after the exchange. Since the computer Johnston, Inc. received in the exchange will not continue to be used in the U.S., the Code Sec. 1031 gain deferral rules will not apply to the exchange. The two-year period is reduced to such lesser time as the taxpayer (or a related person) holds the property relinquished or acquired, unless such shorter holding period is a result of a tax avoidance transaction (or series of such transactions).

Caution. Although the Act did not so specify, it seems apparent that if the exchange of personal property that was thought to be tax-free at the outset later turns out not to be a tax-free exchange because the taxpayer did not continue the same "location of use" after the exchange, the taxpayer would have to file an amended return for the year of the exchange, in order to retroactively report the gain from the exchange. Further, it would seem that the basis of the property would have to be retroactively increased, leading to further complications when computing any allowable depreciation deduction on such property.

Effective date. The "similar in location of use" condition applies to personal property exchanges after June 8, 1997 in tax years ending after such date, unless the exchange is pursuant to a binding contract in effect on such date and at all times thereafter before the disposition of the property. A contract would not fail to be considered to be binding solely because it provided for a sale in lieu of an exchange or the property to be acquired as replacement property was not identified under such contract before June 9, 1997.

Act Sec. 1052(a), amending Code Sec. 1031(h); Act Sec. 1052(b). Law at ¶ 5319. Committee Report at ¶ 11,370.

ACCOUNTING METHODS

Modifications to Long-Term Contract Method

¶ 338

Background

The percentage of completion method relies upon estimated rather than actual contract price and cost to determine gross income from a long-term contract. This use of estimates will inevitably result in the acceleration or deferral of taxes over what would have been reported using actual price and costs throughout the contract term. In order to compensate the taxpayer or the IRS for this difference in taxes, a "look-back" method is applied in the year of contract completion, and is reapplied in later years, for any item of income or cost that is properly taken into account after completion of the contract. The look-back method calculates hypo-

Background

thetical underpayments or overpayments of tax based on actual contract price and costs, to which the taxpayer applies a rate of interest equal to the overpayment rate, compounded daily. Under prior law, this look-back method had to be applied, and related computations had to be made, even when the amounts at issue were *de minimis*. Furthermore, in some cases, under prior law, it was not clear which interest rate had to be used to compute the "look-back" payment.

Long-term contract look-back method modified.—Under the new law, taxpayers who use a long-term contract method of accounting may elect not to apply the look-back method for a long-term contract and may elect not to reapply the look-back method. Both elections would apply to all long-term contracts completed during the tax year for which the election is made and all subsequent years, unless the election is revoked with the consent of the IRS.

Election not to apply look-back method. A taxpayer may elect not to apply the look-back method for a long-term contract if, for each prior contract year, the cumulative taxable income or loss under the contract, as determined using estimated contract price and costs, is within 10 percent of the cumulative taxable income or loss as determined using actual contract price and costs. Thus, under this election, the taxpayer would not be required to apply the additional steps of the look-back method if the reallocation of gross income upon completion of the contract, using actual rather than estimated contract price and costs, resulted in de minimis changes to the amount of taxable income taken into account for each prior contract year.

> **Example (1).** Bob Smith enters into a three-year contract, and, upon completion of the contract, he determines that the annual net income under the contract using actual contract price and costs is $100,000, $150,000 and $250,000 respectively for years 1, 2, and 3 under the percentage of completion method. Assuming Smith makes the proper election, he need not apply the look-back method if he reported net income under the contract of between $90,000 and $110,000 as of the end of year 1, and between $225,000 and $275,000 as of the end of year 2.

Election not to reapply the look-back method. A taxpayer may elect not to reapply the look-back method with respect to a contract if, as of the close of any tax year after the contract is completed, the cumulative taxable income or loss under the contract is within 10 percent of the cumulative look-back income or loss as of the close of the most recent year in which the look-back method was applied (or would have applied but for the application of the *de minimis* exception described above). Amounts that are taken into account after completion of the contract would not be discounted. Thus, an electing taxpayer need not apply or reapply the look-back method if amounts that are taken into account after the completion of the contract are *de minimis*.

> **Example (2).** Bob Smith enters into a three-year contract and reports taxable income of $12,250, $15,000 and $12,750, respectively, for years 1 through 3 with respect to the contract. Upon completion of the contract, cumulative look-back income with respect to the contract is $40,000, and 10 percent of such amount is $4,000. After the completion of the contract, Smith incurs additional costs of $2,500 in each of the next three succeeding years (years 4, 5 and 6) with respect to the contract. Under the new provision, assuming Smith makes the proper election, Smith does not have to reapply the

look-back method for year 4 because the cumulative amount of contract taxable income ($37,500) is within 10 percent of contract look-back income as of the completion of the contract ($40,000). However, the look-back method must be applied for year 5 because the cumulative amount of contract taxable income ($35,000) is not within 10 percent of contract look-back income as of the completion of the contract ($40,000). Finally, the taxpayer does not reapply the look-back method for year 6 because the cumulative amount of contract taxable income ($32,500) is within 10 percent of contract look-back income as of the last application of the look-back method ($35,000).

Applicable interest rate. For purposes of the look-back method, only one rate of interest will apply for each "accrual period." An accrual period begins on the day after the return due date (without extensions) for the tax year and ends on the return due date for the following tax year. The applicable rate of interest is the overpayment rate in effect for the calendar quarter in which the accrual period begins.

Effective date. These long-term contract elections apply to contracts completed in tax years ending after August 5, 1997. The change in the interest rate calculation applies for purposes of the look-back method applicable to the income forecast method of depreciation in the case of property placed in service after September 13, 1995.

Act Sec. 1211(a), adding Code Sec. 460(b)(6); Act Sec. 1211(b), amending Code Sec. 460(b)(2)(C) and adding Code Sec. 460(b)(7); Act Sec. 1211(c). Law at ¶ 5163. Committee Report at ¶ 12,165.

Inventory Shrinkage

¶ 340

Background

Traditionally, the IRS has taken the position that a business may not claim a deduction for inventory shrinkage (i.e., inventory loss due to undetected theft, breakage, or bookkeeping errors) if the amount of the shrinkage was not verified by the taking of a physical year-end inventory. However, some recent court decisions have permitted taxpayers to claim the deduction provided the deduction was based upon a sound method of determining the amount of the shrinkage and the taxpayer's income was still clearly reflected (e.g., *Dayton Hudson Corp.*, 101 TC 462, Dec. 49,404).

Estimates for inventory shrinkage permitted.—A business is generally permitted to determine its year-end closing inventory by taking a reasonable deduction for shrinkage (e.g., inventory loss due to undetected theft). Thus, under this new provision, a business is not required to actually take a year-end inventory in order to determine if any inventory shrinkage has occurred. However, the deduction for the estimated shrinkage may only be claimed if the business:

(1) normally takes a physical count of its inventories at each business location on a regular and consistent basis; and

(2) makes proper adjustments to its inventories and to its estimating methods to the extent its estimates are more or less than the actual shrinkage.

Example (1). On January 4, 1998, Afton, Inc., took an inventory of its goods for sale. At year-end, on December 31, 1998, Afton did not take a year-

end inventory. However, when it filed its 1998 tax return, the corporation claimed a deduction for inventory shrinkage. Based on these facts, Afton would not qualify for such a deduction because it did not take inventories on a regular and consistent basis.

Example (2). Assume the same facts as in Example 1, except that Afton took an inventory every two months during 1998. However, it did not take a December inventory. Based upon these facts, Afton would probably be permitted to make the estimate for inventory shrinkage because it did take inventories on a regular and consistent basis. This would be especially true if Afton took an inventory early in 1999 and made the proper adjustment to reflect the actual amount of inventory shrinkage.

Planning Note. The legislative history to this provision makes clear that Congress did not take a position whether estimates of inventory shrinkage were permitted under prior law. Thus, if a business had been using an estimate for its inventory shrinkage and the IRS has challenged this method, the courts may well sustain the taxpayer's position provided that it used a sound method and its income was not distorted.

Planning Note. According to the legislative history of this provision, Congress expects the IRS to issue safe harbor provisions that may be used for the purpose of estimating inventory shrinkage. The legislative history also outlines a safe harbor which is described below.

Safe harbor provision. Congress anticipates that the following safe harbor provision may be used for taxpayers primarily engaged in the retail trade (i.e., the resale of personal property to the general public). When physical inventories are normally taken at each location at least annually, a safe harbor method will be established by the IRS that will use a historical ratio of shrinkage to sales, multiplied by total sales between the date of the last physical inventory and the year-end. This ratio is to be based on the actual shrinkage established by all physical inventories taken during the most recent three tax years and the sales for the related periods. The ratio is to be separately determined for each store or department in the taxpayer's store. The ratio cannot be adjusted by the taxpayer's judgment or other factors (e.g., floors or caps).

The legislative history shows that Congress expects that the estimated shrinkage determined under the consistent application of the safe harbor method will not be required to be recalculated, through a look-back adjustment or otherwise, to reflect the results of physical inventories taken after the end of the year.

In the situation of a new store or department in the store that has not verified shrinkage by a physical inventory in each of the most recent three tax years, the historical ratio is the average of the historical ratios of the taxpayer's other stores or departments. Retailers using the last in, first out method of inventory are expected to be required to allocate shrinkage among their various inventory pools in a reasonable and consistent manner.

Estimate treated as change in accounting method. If a taxpayer wants to utilize this new provision and begin to estimate its inventory shrinkage, the taxpayer will be treated as if it changed its method of accounting. It is not necessary to secure the permission of the IRS in order to make the change. In addition, any adjustment to income required by Code Sec. 481 because of this change in the method of accounting are required to be reflected over a four- year period.

Effective date. This provision is effective for tax years ending after August 5, 1997.

Act Sec. 961, amending Code Sec. 471(b). Law at ¶ 5167. Committee Report at ¶ 10,835.

Mark-to-Market Election for Certain Traders and Dealers

¶ 341

Background

Under prior law, only *dealers* in securities (e.g., stocks and bonds) used the "mark-to-market" accounting method to compute their income. Generally, under the mark-to-market rules, any securities held by the dealer as inventory must be valued at their fair market value. Any security that is not an inventory item and that is held by the dealer at the end of the tax year is treated as though it had been sold at its fair market value and any gain or loss on the deemed sale is recognized. Gain or loss that is subsequently realized upon the actual sale of the security is adjusted for the gain or loss that was recognized at the earlier date under the mark-to-market rules.

Dealers in commodities and traders in securities or commodities may elect mark-to-market.—Commodities dealers and traders of securities or commodities are now permitted to make an election to use the mark-to-market accounting method. Previously, the mark-to-market rules only applied to securities dealers.

Caution. Dealers in securities are still generally required to use the mark-to-market rules for valuing their inventory. This new provision gives the option to make the mark-to-market election only to commodities dealers and traders in securities or commodities.

Traders v. dealers. Traders are taxpayers who are in the business of actively selling, buying or exchanging securities or commodities in the market. On the other hand, *dealers* deal directly with their own customers when they regularly buy or sell securities or commodities in the course of their business.

Commodities dealers. When a *dealer* in commodities elects to use the mark-to-market method for valuing commodities that are held by it in its business, the dealer will generally be subject to the same rules that previously applied only to securities dealers. Basically, these rules provide that a commodity held as inventory must be valued at its fair market value. Any commodity that is not inventory and that is held at the end of the year will be treated as if it was sold at its fair market value.

Commodity defined. For these purposes, a "commodity" is defined as:

(1) any commodity that is actively traded;

(2) any notional principal contract with respect to any commodity that is actively traded;

(3) any evidence of an interest in, or a derivative instrument in, any of the commodities described in (1) and (2), above; and

(4) any position that (a) is not a commodity described in (1), (2), or (3), above; (b) is a hedge with respect to the commodity; and (c) is clearly

identified in the dealer's records as meeting these requirements before the close of the day on which it was acquired or entered into.

Caution. With respect to the requirement that the dealer identify the commodity before the close of the day it was acquired or entered into, the IRS has been given the authority to modify the deadline.

Making the election. A commodities dealer may make the mark-to-market election without the consent of the IRS. However, once the election has been made, the election may not be revoked without the permission of the IRS.

Traders in securities or commodities. When a taxpayer engaged in the business of trading securities *or* commodities makes the election to use the mark-to-market method of valuation, the following rules apply:

(1) the trader is required to recognize gain or loss on any security or commodity held in connection with its business at the close of its tax year;

(2) gain or loss is determined as if the security or commodity were sold at its fair market value on the last business day of the tax year; and

(3) the gain or loss is taken into account by the trader for that tax year.

The IRS is given the authority to modify the time periods set forth above.

Planning Note. The mark-to-market election requires the trader to recognize gain or loss on securities or commodities that it still owns. However, when the trader subsequently sells such property, it may take into account this prior gain or loss in order to determine the amount that it actually realized from the sale.

Caution. The legislative history indicates that Congress did not intend that a securities trader could mark to market loans made to customers, or receivables or debt instruments acquired from customers, that are **not** received or acquired in connection with its business of being a securities trader.

Securities or commodities held for investment are excluded. When a trader in securities or a commodities trader or dealer makes the election to use the mark-to-market rules, only securities or commodities held by the taxpayer and used in its business are subject to the election. Securities or commodities held for investment and so identified are not subject to the election. In order to have securities or commodities exempt from the mark-to-market rules, the trader must:

(1) establish to the satisfaction of the IRS that the property has no connection to the business activities of the trader; and

(2) clearly identify the investment property in its records.

If a security or commodity is identified as investment property and then becomes business property, the mark-to-market rules apply to changes in the value of the property that occur after the time it became business property.

Caution. Congress was concerned about issues involving the ability of traders to identify securities or commodities held for investment. Thus, the taxpayer must be able to show by clear and convincing evidence that the security or commodity bears no relation to the business activities of the trader in order to avoid the mark to market rule for such property. The legislative history indicates that any security that hedges another security that is held in connection with the trader's business cannot be classified as investment property.

Planning Note. Securities or commodities that are held for investment on the day of enactment must be identified as investment property on or before the 30th day after this provision is enacted into law.

Caution. In order to exclude investment securities or investment commodities from the mark-to-market election, the taxpayer must clearly identify the investment property on its records. In most situations, identification must be made *before* the close of the *day* on which the property was acquired, originated, or entered into. The IRS has regulatory authority to modify this time period.

Any security to which the mark-to-market rule applies and which was acquired by the taxpayer in the course of the business of being a security trader is not taken into account when applying the Code Sec. 1259 constructive sales rules on appreciated financial positions.

Making the election. At this time, Congress has not provided any details concerning how a trader is to make the election. However, it is clear that an election must be made for each separate business of the trader.

Caution. The taxpayer does not need the permission of the IRS to make the election. However, once made, the election is irrevocable, unless the IRS grants permission to revoke the election. Thus, care should be exercised before the election is made.

> **Example.** Marsha Smith owns the following businesses: (1) securities trading and (2) commodities trading. If Smith wants to use the mark-to-market rule for both businesses, she must make two separate elections. On the other hand, she may make an election to use the mark-to-market rule for just one of her businesses.

Accounting change. Any taxpayer that makes the election to use the mark-to-market rules is treated as though it changed its method of accounting. Any adjustment required under Code Sec. 481 as a result of this change in accounting is to be taken into account ratably over four tax years. The four-year period begins with the year in which the election is first effective.

Planning Note. According to the Conference Committee Report, Congress intended that the special rule pertaining to Code Sec. 481 adjustments applies only to taxpayers that make the mark-to-market election for the tax year that includes the date this provision was enacted into law. Any election made in a subsequent tax year is to be governed by rules and procedures that will be established by the IRS.

Effective date. The election applies to tax years ending after August 5, 1997.

Act Sec. 1001(b), redesignating Code Sec. 475(e) as (g) and adding new subsections (e) and (f); Act Sec. 1001(d)(4). Law at ¶ 5169. Committee Report at ¶ 11,120.

Manufacturer-to-Dealer Installment Sale Election

¶ 343

Background

As a general rule, the installment sales method of accounting may not be used by dealers in personal property. However, under prior law, if specific requirements were met, a manufacturer of tangible personal property could use the installment sales method to report the income from sales of property to its dealers. In order to

Background

be able to use the installment sales method, it had to be intended that the property was to be sold or leased by the dealer. In addition, the dealer had to be obligated to make principal payments only when it sold or rented the property, and the manufacturer had to have the right to repurchase the property at a fixed or determinable price within nine months of selling the property to the dealer.

Repeal of special installment sales rule.—The special provision that allowed manufacturers of tangible personal property to use the installment method to report income from sales to their dealers has been repealed.

Repeal treated as change in method of accounting. A manufacturer that is affected by the repeal of this provision will be treated as though it changed its method of accounting. The change will be treated as though the IRS has given its consent. Any adjustments required by this change in accounting method must be taken into account ratably over four tax years. The four-year period begins with the first tax year that starts after the date that the repeal is enacted into law.

Planning Note. Because the required change in accounting is treated as though the IRS has already given its permission, the manufacturer need not file Form 3115, Application for Change in Accounting Method.

Caution. Even though the manufacturer need not file Form 3119 with the IRS asking for permission to change its method of accounting, it is possible that the IRS, at a later date, will require taxpayers to indicate on their tax returns that the change was made.

Effective date. The repeal is effective for tax years beginning more than one year after August 5, 1997.

Act Sec. 1088(a), repealing Act Sec. 811(c)(2) of the Tax Reform Act of 1986; Act Sec. 1088(b). Law at ¶ 7034. Committee Report at ¶ 11,550.

Pooled Debt Obligations

¶ 345

Background

Real estate mortgage investment conduit (REMIC) interests, mortgages held by REMICs, and debt instruments whose principal payments may be accelerated are subject to a special rule for computing original issue discount (OID) on the debt. Under this rule, if a borrower can reduce the yield on the debt by prepaying it, the amount of OID on such debt is determined by making a reasonable assumption regarding the portion of the debt that will be prepaid. Under prior law, a taxpayer that held pooled debt instruments, such as a pool of credit card receivables, was not subject to this rule. Thus, the holder was able to assume that *all* of the debt would be timely paid and avoid accrual of interest income on the debt.

OID on pooled debt.—The rule for determining original issue discount (OID) on interests in and mortgages held by real estate mortgage investment conduits (REMICs) and on other debt instruments whose principal payments may be accelerated now applies to pooled debt instruments. Pooled debt instruments are debt instruments whose yield may be affected by prepayments or other events to the extent set forth in regulations. One example of pooled debt is a pool of credit

card receivables on which interest must be paid if the borrowers do not pay their account balances by a particular date.

Under the rule, interest or OID must be accrued on pooled debt based on a reasonable assumption regarding the timing and portion of the debt that will be prepaid. According to the House Committee Report, if payments occur soon after the end of the year and before the taxpayer files its tax return for the year, interest may be accrued according to the taxpayer's actual payment experience, rather than on reasonable assumptions.

> **Example.** A credit card issuer charges interest on account balances that are not paid within 21 days after the close of the billing period but not on account balances that are timely paid. The taxpayer holds pooled debt of $1,000,000 on December 31, 1998, which will not be considered overdue until January 15, 1999. The taxpayer must accrue interest for 1998 based on a assumption that a portion of the $1,000,000 will not be paid on time. However, the accrued amount may be adjusted in 1999 to reflect the actual payment of the outstanding credit account balances.

Specifically, the daily portion of OID on pooled debt, as well as on REMIC interests, REMIC mortgages, and debt on which payment may be accelerated, is determined by allocating to each day in an accrual period the ratable portion of the excess of: (1) the present value of the remaining payments plus payments during the accrual period of amounts included in the stated redemption price of the debt instrument, over (2) the adjusted issue price of the debt instrument at the beginning of the period.

Planning Note. A small business engaged in the trade or business of selling tangible personal property at retail will not be subject to this rule for debt instruments incurred in the ordinary course of its trade or business while the debt is held by the business.

Change in accounting method. For any taxpayer who is required to change its method of accounting for the first tax year beginning after August 5, 1997 in order to comply with the new rules for pooled debt obligations, the change will be treated as initiated by the taxpayer and made with the IRS's consent. The net amount of Code Sec. 481 adjustments required to effect the change must be taken into account ratably over four tax years beginning with the first tax year beginning after August 5, 1997.

Caution. The Conference Committee Report clarifies that the IRS has discretion over whether or not to grant permission for taxpayers to change their method of accounting for pooled debt where the requests are pending for years before August 5, 1997.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1004, amending Code Sec. 1272(a)(6)(C)(i) and (ii) and adding new Code Sec. 1272(a)(6)(C)(iii). Law at ¶ 5359. Committee Report at ¶ 11,135.

WORKERS' COMPENSATION

Assignment of Workers' Compensation Liability

¶ 347

Background

Under prior law, the exclusion under Code Sec. 130 for qualified personal injury liability assignments did not include amounts assigned for assuming a liability to pay compensation under a workers' compensation act.

Assignment of workers' compensation liability.—The exclusion under Code Sec. 130 for qualified personal injury liability assignments has been extended to amounts assigned for assuming a liability to pay compensation under any workers' compensation act. The exclusion is available to the assignee for the amount received to the extent that it does not exceed the aggregate cost of any qualified funding asset. The liability must be assumed from a person who is a party to the workers' compensation claim. Also, the periodic payments made under the assignment must be fixed and determinable as to amount and time of payment; they cannot be subject to acceleration, deferral, increase or decrease by the recipient; the assignee's obligation cannot be greater than that of the person whose liability is assumed; and the payments must be excludable from the recipient's gross income under Code Sec. 104(a)(1).

Effective date. The provision is effective for workers' compensation claims filed after August 5, 1997.

Act Sec. 962(a), amending Code Sec. 130(c). Law at ¶ 5053. Committee Report at ¶ 10,840.

STATE AND LOCAL BONDS

Mortgage Subsidy Financing

¶ 349

Background

Current law allows an exemption from tax for interest earned on qualified mortgage revenue bonds. Generally, limitations restrict the availability of mortgage subsidy bonds on first-time buyers and also impose limits on income and purchase prices. These limits do not apply if the loans are made to finance homes in targeted distressed areas. However, under prior law, no exception to the requirements existed for bonds used to finance rebuilding of homes in Presidentially declared disaster areas.

Financing for residences in disaster areas.—Interest on mortgage revenue bonds, qualified mortgage bonds, and qualified veteran's mortgage bonds is tax exempt, provided certain requirements are satisfied. Currently, three requirements that are normally applicable in order to qualify for tax exemption on mortgage revenue bonds do not apply if the financing is used for homes in a statutorily prescribed economically distressed area. The Act now waives these requirements for loans made to finance homes in Presidentially declared disaster areas as well. The first requirement that is waived exempts participants from meeting a three-year nonownership requirement. Second, the purchase price requirement or the

income limitations are applied as if the residence were a targeted area residence. Thus, the purchase price of a bond-financed residence may not exceed 110 percent of the average area purchase price. Third, with respect to income limitations, one third of the financing may be provided without regard to income limitations set forth for other mortgage financing.

A residence is located in a disaster area if the area is determined by the President to warrant assistance from the federal government under the Disaster Relief and Emergency Assistance Act, as in effect on August 5, 1997. Financing must be provided within two years after the date the disaster is declared.

Effective date. The provisions are effective for loans financed with bonds issued after December 31, 1996 and before January 1, 1999.

Act Sec. 914, adding Code Sec. 143(k)(11). Law at ¶ 5061. Committee Report at ¶ 10,615.

Virgin Island Bonds

¶ 351

Background ___

A governmental bond that is issued after 1985 may generally be advance refunded one time. Currently, Virgin Islands bonds are required to be secured with a priority first lien claim on specified revenue streams instead of being permitted to issue multiple bond issues secured on a parity basis by a common pool of revenues.

Refunding rules for certain tax-exempt bonds modified.—Governmental bonds issued by the Virgin Islands that were first advance refunded before June 9, 1997, are allowed one additional advance refunding. The refunding is allowed if the Virgin Islands debt provisions are changed to repeal the current priority first lien requirement. An advance refunding is any refunding where all of the refunded bonds are not redeemed within 90 days after the refunding bonds are issued.

Effective date. The non-Code law change that would provide for an additional advance refunding is effective on August 5, 1997.

Act Sec. 967. Law at ¶ 7015A. Committee Report at ¶ 10,865.

501(c)(3) Bond Limitation

¶ 353

Background ___

Interest on private activity bonds issued on behalf of Code Sec. 501(c)(3) organizations other than hospitals is not taxable, subject to certain restrictions. Prior to the Taxpayer Relief Act of 1997, one restriction limited the aggregate face amount of bonds issued on behalf of a 501(c)(3) organization to $150 million.

Repeal of $150 million limit on qualified 501(c)(3) bonds.—The Act terminates the $150 million limitation in the case of bonds issued after August 5, 1997 if the bonds are part of an issue, 95 percent or more of the net proceeds of which are to be used to finance capital expenditures incurred after such date.

The Conference Committee Report clarifies that, because the provision applies only to bonds issued with respect to capital expenditures incurred after August 5, 1997, the $150 million limitation will continue to govern issuance of other nonhospital qualified Code Sec. 501(c)(3) bonds (for example, refunding bonds or new-money bonds for capital expenditures incurred before August 5, 1997). The IRS is expected to provide guidance and interpretative rules on the application of this limit.

Effective date. The provision applies to bonds issued after August 5, 1997 to finance capital expenditures incurred after August 5, 1997.

Act Sec. 222, adding Code Sec. 145(b)(5). Law at ¶ 5063. Committee Report at ¶ 10,220.

ARBITRAGE PROFITS

Limitation on Unspent Proceeds

¶ 355

Background

Interest on private activity bonds (bonds issued by a state or local government to finance private parties) is generally taxable, unless the financed activity is specified in the Code and at least 95 percent of the proceeds are used to finance the specified activity. State and local bond issuers must also satisfy arbitrage restrictions for issued bonds. Arbitrage profits from investing bond proceeds in investments unrelated to the governmental purpose of the bond must be rebated to the federal government. No rebate is required if the gross receipts of an issue are spent for the governmental purpose of the borrowing within six months after the date of issuance. Until the Taxpayer Relief Act of 1997, this six-month exception was deemed to be satisfied by issuers of certain government bonds and qualified Code Sec. 501(c)(3) bonds if (1) all the proceeds other than the amount not exceeding the lesser of five percent, or $100,000, are so spent within six months and (2) the remaining proceeds were spent within one year after the bond was issued.

Repeal of $100,000 limitation on unspent proceeds under one-year rebate exception.—Under the Act, the $100,000 limit on proceeds that may remain unspent after six months is eliminated. Thus, if at least 95 percent of the proceeds of these bonds are spent within six months after their issuance, and the remainder in one year, the six-month rebate exception is deemed to be satisfied and the arbitrage restrictions will not apply.

Effective date. The provision is effective for bonds issued after August 5, 1997.

Act Sec. 1441, amending Code Sec. 148(f)(4)(B)(ii); Act Sec. 1445. Law at ¶ 5065. Committee Report at ¶ 12,915.

Construction Issues

¶ 356

Background

Under current law, arbitrage rebate requirements do not apply to certain construction bond issues if the issues are spent at specified rates during the 24-month period after the bonds are issued. Under prior law, the exception did not

Background

apply to bond proceeds invested after the 24-month period as part of a reasonably required reserve or replacement fund, a bona fide debt service fund, or to other investments such as sinking funds. Issuers of construction bonds could elect to comply with a penalty scheme in lieu of rebating arbitrage profits if the spending requirements were not met.

Rebate exception under construction bond rules.—Earnings on bond proceeds invested in bona fide debt service funds are excepted from the arbitrage rebate requirement and the penalty requirement of the 24-month exception if the spending requirements of Code Sec. 148(f)(4)(C)(2) are met. According to the House Committee Report, the short-term nature of investments in bona fide debt service funds results in only a limited potential for generating arbitrage profits. The administrative complexity of calculating rebate on construction bond proceeds prompted the exemption from the rebate rules in cases where the spending requirements of the arbitrage rebate rules are met.

Effective date. The provision applies to bonds issued after August 5, 1997.

Act Sec. 1442, adding Code Sec. 148(f)(4)(C)(xvii); Act Sec. 1445. Law at ¶ 5065. Committee Report at ¶ 12,920.

Nonpurpose Investments

¶ 357

Background

Under current law, the direct investment of profits earned on a bond issue in certain high-yield nonpurpose investments may cause such bonds to be classified as arbitrage bonds. Prior law provided that one exception to this rule allowed bond proceeds to be invested at materially higher yields at any time during a bond year to 150 percent of the debt service for that bond year. This restriction was enacted before the imposition of other rules restricting the amount of arbitrage profits earned on nonpurpose investments.

Repeal of debt service yield restriction.—The new law repeals the exception to arbitrage bond classification, which allowed private activity bond proceeds to be invested at materially higher yields provided they did not at any time exceed 150 percent of the debt service for the bond year. According to the House Committee Report, the 150-percent rule, which was enacted prior to other arbitrage bond restrictions, is no longer necessary. Bonds must continue to comply with comprehensive yield restrictions and arbitrage rebate requirements and must maintain reserve funds within the limits prescribed under Code Sec. 148.

Effective date. The provision applies to bonds issued after August 5, 1997.

Act Sec. 1443, striking Code Sec. 148(d)(3); Act Sec. 1445. Law at ¶ 5065. Committee Report at ¶ 12,925.

Repeal of Expired Provisions

¶ 358

Expired provisions.—Two exceptions to the arbitrage rebate requirement and the pooled financing requirement for arbitrage bonds exist for certain qualified

student loan bonds issued before January 1, 1989. These provisions have been repealed as deadwood.

Effective date. The provision is effective for bonds issued after August 5, 1997.

Act Sec. 1444(a), striking Code Sec. 148(c)(2)(B) and redesignating Code Sec. 148(c)(2)(C), (D) and (E) as Code Sec. 148(c)(2)(B), (C) and (D); Act Sec. 1444(b), striking Code Sec. 148(f)(4)(E); Act Sec. 1445. Law at ¶ 5065. Committee Report at ¶ 12,930.

Arbitrage Rebate Exception

¶ 359

Background

Under prior law, the "small issuer" exception to tax-exempt bond arbitrage rebate rules could not apply when a governmental unit expected to issue more than $5,000,000 of tax-exempt bonds during a calendar year.

Expansion of the arbitrage rebate exception for certain bonds.—The dollar limit of the "small issuer" exception to the rule requiring a tax-exempt bond issuer to rebate arbitrage profits earned on investments unrelated to the purpose of the bond issuance is raised for tax-exempt bonds issued after 1997 that are used to finance public school capital expenditures. As was the case under prior law, the bonds cannot be private activity bonds and must be issued by a governmental unit with general taxing powers. The $5,000,000 per calendar year limit on the amount of such tax-exempt bonds that can be issued under the "small issuer" exception is raised by up to an additional $5,000,000, equal to the aggregate face amount of the bonds issued that is attributable to financing the construction of public school facilities. Thus, according to the Senate Committee Report, small issuers will continue to benefit from the exception to arbitrage rebate if they issue no more than $10 million in governmental bonds per calendar year and no more than $5 million of the bonds is used to finance expenditures other than for public school capital expenditures.

Caution. The Senate Committee Report indicates that the bonds must be issued to finance public school capital expenditures *incurred after* December 31, 1997.

Effective date. The expansion of the arbitrage rebate exception applies to bonds issued after December 31, 1997.

Act Sec. 223(a), amending Code Sec. 148(f)(4)(D); Act Sec. 223(b). Law at ¶ 5065. Committee Report at ¶ 10,225.

FARMERS

Income Averaging

¶ 361

Background

Under prior law, farmers could not average income over any period of years. Prior to the Tax Reform Act of 1986, individuals could reduce their tax liability by averaging income over a number of years.

Income averaging available to farmers.—An individual engaged in a farming business may elect to average farm income over three years. The tax imposed in any tax year will equal the sum of the tax computed on taxable income reduced by "elected farm income" plus the increase in tax that would result if taxable income for each of the three prior tax years were increased by an amount equal to one-third of the elected farm income. The Conference Committee Report states that the election is irrevocable, except as will be provided in regulations.

Farming business and income. Elected farm income means the amount of taxable income attributable to any farming business that is specifically subject to this three-year averaging election. Gain from the sale or disposition of property, other than land, regularly used by the farmer for a substantial period in such a farming business is treated as attributable to a "farming business." A farming business is the trade or business of farming, including operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts or other crops, or ornamental trees.

Planning Note. The three-year income averaging election is provided in recognition of the sometimes erratic nature of the farming business. Farmers are confronted with numerous variables beyond their control that greatly affect cash-flow, profits, losses and ultimately tax liability. This provision is designed to smooth out the economic disparities that may occur from year to year. However, it is important to keep in mind that the farmer should "do the math" because this election will not always be beneficial. For example, a farmer who suffered low-income years followed by a very good year will benefit as farm income taxed at the 28-percent rate or higher is shifted to the 15-percent bracket, while a farmer consistently in the 28-percent tax bracket would be worse off by averaging farm income.

Guidelines. An adjustment under this election for any tax year is taken into account when applying this provision to subsequent tax years. Also, the election is not available to estates or trusts, and, according to the Conference Committee Report, it does not apply for employment tax or alternative minimum tax purposes. Moreover, the Conference Committee Report suggests that the provision does not require the recalculation of the tax liability of any other taxpayer, including a minor child required to use the tax rates of his or her parents under Code Sec. 1(g). Further, regulations will be provided regarding the order and manner in which items of income, gain, deduction or loss, or limitations on tax will be taken into account, as well as the treatment of any short tax years.

Effective date. This provision applies to tax years beginning after December 31, 1997, and before January 1, 2001.

Act Sec. 933(a), adding Code Sec. 1301; Act Sec. 933(b) and (c). Law at ¶ 5373. Committee Report at ¶ 10,665.

AMT and Installment Sales

¶ 363

Background

Under prior law, it was not clear whether farmers could use the installment method to account for dispositions of property used or produced on a farm for purposes of computing their alternative minimum tax (AMT) liability. For regular tax purposes, dealers in personal property cannot use the installment method to account for the sale of such property. Under the regular tax system, dealer dispositions do not include sales of property used or produced in the trade or

Background

business of farming. However, no similar exception applied under the AMT system. Under the AMT, the installment method could not be used to account for the disposition of any property that was the stock in trade of the taxpayer or any other property of a kind that would have been properly included in the inventory of the taxpayer if held at year-end, or property held by the taxpayer for sale to customers.

The IRS held in IRS Letter Ruling 9640003 that the installment method could not be used for sales of property produced on a farm, for purposes of computing an AMT liability. Later, the IRS announced that it would not apply this position for tax years beginning before 1997 (Notice 97-13, January 28, 1997), so long as the farmer changed its method of accounting for installment sales in post-1996 tax years. Congress intended to resolve this issue in favor of the farmer.

Treatment of installment sales for AMT purposes.—Code Sec. 56(a)(6), which generally provides that the installment method may not be used to compute alternative minimum tax liability in the case of a post-March 1, 1986 disposition of stock in trade, inventory, or property held primarily for sale to customers is repealed. The repeal should primarily benefit farmers insofar as dealers of personal property (with the exception of farmers) are not allowed to use the installment method for regular tax purposes (Code Sec. 453(l)(2)(A)).

Effective date. The repeal applies to dispositions in tax years beginning after December 31, 1987. However, under a special rule, the repeal also applies to cash-basis farmers in the case of a tax year beginning in 1987.

Act Sec. 403(a), amending Code Sec. 56(a)(6); Act Sec. 403(b). Law at ¶ 5031. Committee Report at ¶ 10,345.

Suspense Accounts for Family Farm Corporations

¶ 365

Background

A family farming corporation with gross receipts that exceed $25,000,000 is required to use the accrual method of accounting for the farming business. Generally, a family farming corporation is one where at least 50 percent of the stock is owned by the same family. Under prior law, when a family corporation was required to change to the accrual method it was permitted to establish a suspense account. The suspense account acted as a relief provision in that its purpose was to permit the corporation to defer reporting the income that resulted from the required change in its accounting method.

Suspense accounts may no longer be established.—When a family farm corporation is required to change from the cash method to the accrual method in the year that its gross receipts exceeds $25,000,000, the corporation may no longer establish a suspense account to defer reporting the income that results from the change in its method of accounting. Instead, such corporations are now subject to the same rules as large farming corporations. That is, the income adjustment caused by the change in accounting (i.e., the "Code Sec. 481(a)" adjustment) is spread over a period of 10 years beginning with the year of the change in the method of accounting.

Example (1). Silo, Inc., is a family farm corporation that files its corporate tax return on a calendar year basis. The corporation's gross income

has always been $25,000,000 or less, and it has used the cash method of accounting. However, in 1997 its gross receipts will exceed $25,000,000. As a result, Silo, Inc. must convert to the accrual method of accounting. Any additional income that results from this change in its method of accounting may no longer be placed in a suspense account. Instead, the corporation must recognize the income over a 10-year period as required by Code Sec. 447(f)(3).

Existing suspense accounts will be phased out. Generally, a family farm corporation with an existing suspense account will be required to include a portion of the suspense account in its gross income over a number of years. The amount to be included in each year's gross income is equal to the *lesser* of:

(1) the amount that would ratably reduce the remaining amount in the suspense account to zero over the first 20 tax years; or

(2) 50 percent of the taxable income of the corporation's taxable income for the year, or if the corporation has no taxable income for the year, the amount of its net operating loss for the tax year.

For any tax year during the period over which a suspense account is being phased out, a corporation's taxable income or net operating loss will be determined without regard to any amount included in income from the suspense account.

Example (2). Tiller, Inc., is a family farm corporation that files on a calendar year basis and that was required to change from the cash method of accounting to the accrual method a few years ago. For the year of the change, Tiller was able to place $50,000 in a suspense account. Under the new law, the suspense account will be phased out. For 1997, Tiller's taxable income is $100,000. As a result, Tiller must include $2,500 of the suspense account in its gross income because this amount is the *lesser* of $50,000 ÷ 20 years ($2,500) or 50% of $100,000 in taxable income ($50,000).

Planning Note. The rule that required the acceleration of the recovery of suspense accounts when the gross receipts of the taxpayer decreased, has been repealed.

Amounts remaining in suspense accounts after 20 years. If any amount remains in a suspense account after 20 years, the amount to be included in the corporation's gross income on a yearly basis is to be computed under the same formula used for the first 20 years.

Planning Note. According to the legislative history, it is the intent of Congress that in the case of a family farm corporation that elects S corporation status, the net operating loss and 50 percent of taxable income limitations are to be determined by taking into account all the items of income, gain, deduction and loss of the corporation, whether or not such items are separately stated under Code Sec. 1366.

Effective date. This provision is effective for tax years ending after June 8, 1997.

Act Sec. 1081(a), amending Code Sec. 447(i)(5); Act Sec. 1081(b). Law at ¶ 5157. Committee Report at ¶ 11,515.

Weather-Related Livestock Sales

¶ 367

Background

A cash method taxpayer whose principal trade or business is farming and who is forced to sell livestock due to drought conditions may elect to include income from the livestock sale in the tax year following the year of the sale. In addition, the sale of livestock, other than poultry, that is held for draft, breeding, or dairy purposes in excess of the number of livestock that would have been sold but for the drought conditions is treated as an involuntary conversion. Consequently, gain from the sale of such livestock could be deferred by reinvesting the sale proceeds in similar property within a two-year period. Prior to the Taxpayer Relief Act of 1997, this election to defer the recognition of gain until the tax year following the year of the sale of livestock, and the "involuntary conversion" election to defer gain through the reinvestment of livestock sale proceeds, only applied to sales on account of drought conditions; it did not apply to sales on account of flood or other weather-related conditions that resulted in an area being designated as eligible for federal assistance.

Livestock sold on account of weather-related conditions.—The election to defer the recognition of income from the sale of livestock sold on account of drought, or to treat the sale of livestock sold on account of drought as an involuntary conversion, is extended to sales that occur as a result of flood or other weather-related conditions that resulted in the area being designated as eligible for federal assistance. Thus, the sale of livestock, other than poultry, that are held for draft, breeding, or dairy purposes in excess of the number of livestock that would have been sold but for the weather-related conditions is treated as an involuntary conversion. Similarly, a cash basis taxpayer whose principal trade or business is farming and who is forced to sell livestock due to drought, floods or other weather related conditions may elect to include income from the sale of the livestock in the tax year following the year of sale. This elective deferral is available only if the taxpayer establishes that, under the taxpayer's usual business practices, the sale would not have occurred but for the adverse weather-related conditions.

> **Example.** William Robert Smith, a calendar year taxpayer, normally sells 100 head of beef cattle per year. As the result of flood conditions existing during 1997, Smith sells 135 head during that year. Smith realizes $35,100 of income from the sale of the 135 head. On August 9, 1997, as a result of the flood, the affected area was declared a disaster area and thereby eligible for federal assistance. The amount of income which Smith may defer until 1998, presuming the other applicable conditions are met is $9,100 ($35,100, the total income from sales of beef cattle, divided by 135, the total number of beef cattle sold, multiplied by 35, the excess number of beef sold (135 − 100)).

Effective date. These livestock-sale provisions apply to sales and exchanges after December 31, 1996.

Act Sec. 913(a), amending Code Sec. 451(e); Act Sec. 913(b), amending Code Sec. 1033(e); Act Sec. 913(c). Law at ¶ 5159 and 5321. Committee Report at ¶ 10,595.

Sale of Stock to Farmers' Cooperatives

¶ 369

→ Caution: Act Sec. 1175 was canceled by President Clinton on August 11, 1997, pursuant to his authority under the Line Item Veto Act (P.L. 104-130). As we go to press, this provision is deemed to be stricken from the Act. However, under the procedures set out in P.L. 104-130 (or as the result of a successful challenge of its constitutionality), this provision may be reinstated at a later date.←

Background

If certain requirements are satisfied, a taxpayer may defer recognition of gain on the sale of qualified securities to an employee stock ownership plan ("ESOP") or to an eligible worker-owned cooperative, to the extent that the taxpayer reinvests the proceeds in qualified replacement property. Gain is recognized when the taxpayer disposes of the qualified replacement property. One of the requirements that must be satisfied for deferral to apply is that, immediately after the sale, the ESOP must own at least 30 percent of the stock of the corporation issuing the qualified securities. In general, qualified securities are securities issued by a domestic C corporation that has no stock outstanding that is readily tradable on an established securities market. Deferral treatment does not apply to gain on the sale of qualified securities by a C corporation. Before the Taxpayer Relief Act of 1997, there was no similar gain deferral provision that applied to the sale of stock of a qualified refiner or processor to an eligible farmers' cooperative.

Nonrecognition of gain on sale of stock to farmers' cooperatives.—A taxpayer may elect to defer the recognition of gain from the sale of stock of a qualified agricultural refiner or processor to an eligible farm cooperative under the Code Sec. 1042 gain deferral rules that apply to the sale of stock to employee stock ownership plans (ESOPs) or to worker-owned cooperatives. Assuming the proper election is made and the other applicable conditions satisfied, the gain from the sale will generally not be recognized to the extent that the sale proceeds are timely invested in qualified replacement property, which is generally the stock, or security, of an unrelated domestic operating corporation that did not have excessive passive investment income. The basis of the qualified replacement property is reduced by the gain not recognized. Thus, the recognition of such gain is deferred until the qualified replacement property is sold.

Qualified refiner or processor and eligible farmer' cooperative. Generally, a qualified refiner or processor is a domestic corporation, substantially all of the activities of which consist of the active conduct of the trade or business of refining or processing agricultural or horticultural products. However, such a corporation is qualified only if, during the one-year period ending on the date of sale, it buys more than one-half of such products to be refined or processed from the eligible farmers' cooperative that is purchasing its stock or from the farmers who make up such cooperative that is purchasing its stock. An eligible farmers' cooperative is an organization that is treated as a cooperative for federal income tax purposes and that is engaged in the marketing of agricultural or horticultural products.

Special rules for sale of qualified refiner or processor stock. There are a few differences between the gain deferral rules that apply to the sale of stock to an ESOP or a worker-owned cooperative and the gain deferral rules that apply to the sale of stock of a qualified refiner or processor. The eligible farmers' cooperative is

treated in the same manner as an eligible worker-owned cooperative, except that the majority of its board of directors does not have to be elected by the members on the basis of one person, one vote. Also, deferral from the sale of a qualified refiner or processor's stock is available only if, immediately after the sale, the eligible farmers' cooperative owns 100 percent of the qualified refiner or processor. Furthermore, the determination of whether any stock in the domestic corporation is a qualified security is made without regard to whether the stock is an employer security. Moreover, the gain deferral provision applies even if the stock of the qualified refiner or processor is publicly traded or is sold by a C corporation.

Effective date. The nonrecognition rules apply to sales after December 31, 1997.

Act Sec. 968(a), adding Code Sec. 1042(g); Act Sec. 968(b). Law at ¶ 5331. Committee Report at ¶ 10,870.

EMPOWERMENT ZONES

Additional Empowerment Zones

¶ 371

Background

In an attempt to provide economic revitalization to distressed urban and rural areas, special tax incentives are provided for nine empowerment zones (three rural and six urban) and 95 enterprise communities (30 rural and 65 urban). Certain criteria relating to each area's population, degree of distress, size, and rate of poverty must be met for an area to be designated as an empowerment zone under current law. In addition, prior to amendment by the Act, the aggregate population of all urban zones could not exceed 750,000 persons.

The six urban empowerment zones are Atlanta, Baltimore, Chicago, Detroit, New York City, and Philadelphia-Camden. The three rural empowerment zones are Kentucky Highlands, Kentucky; Mid-Delta, Mississippi; and Rio Grande Valley, Texas. These areas were designated in 1994. The designations remain in effect for 10 years, or until the date designated in the nominating document, unless revoked for modification of the area's boundaries or failure to comply with the agreed strategic plan. In addition to the nine empowerment zones, two supplemental urban zones, Los Angeles and Cleveland, receive economic development grants but not special tax incentives.

Qualified businesses operating in empowerment zones are eligible to finance property using enterprise zone financing bonds, which are considered exempt facility private activity bonds. Two additional incentives are available in empowerment zones. Specifically, qualifying businesses are entitled to expense up to an additional $20,000 under Code Sec. 179 (Code Sec. 1397A), and employers are entitled to a tax credit with regard to wages paid to certain zone employees (Code Sec. 1396).

Two additional empowerment zones authorized.—Two additional urban-area empowerment zones may be designated by the Secretary of Housing and Urban development. This increases the number of empowerment zones authorized for urban areas from six to eight. The number of empowerment zones authorized for rural areas is not increased and remains at three. Although the designations

must be made within 180 days of August 5, 1997, the designation can not take effect before the year 2000.

In contrast to the 20 additional empowerment zones permitted under new Code Sec. 1391(g) (see ¶ 372), these two additional empowerment zones are subject to the same eligibility criteria as applied to the original six zones. However, in order to accommodate the increased number of zones, the present-law aggregate population limitation for all empowerment zones of 750,000 has been increased to one million.

In general, the same tax incentives apply to the two additionally authorized zones as apply to the original six zones. For example, the additional expensing allowances and special tax-exempt financing would apply. However, modifications are made to the applicable percentage of wages taken into account in determining the amount of the wage credit for the two newly authorized zones.

Wages Paid or Incurred During Calendar Year in Two New Empowerment Zones	*Applicable Percentage*
2000—2004	20%
2005	15%
2006	10%
2007	5%

These modifications extend the years for the phase out of the applicable percentage, thus enabling employers within the newly authorized empowerment zones to claim a larger empowerment zone employment credit than would be the case under the present percentage phase out that reduce to zero in 2005.

Effective date. This provision takes effect on August 5, 1997. Designations of new empowerment zones pursuant to this provision must be made during the 180-day period beginning on August 5, 1997 (February 1, 1998). No designation made under this provision can take effect before January 1, 2000.

Act Sec. 951(a), amending Code Sec. 1391(b); Act Sec. 951(b), amending Code Sec. 1396(b); Act Sec. 951(c). Law at ¶ 5379 and 5385. Committee Report at ¶ 10,735.

New Empowerment Zones

¶ 372

Background

Certain criteria relating to an area's population, degree of distress, size, and rate of poverty must be met for an area to be designated as an empowerment zone under current law.

An urban empowerment zone's maximum population is limited to the lesser of either (1) 200,000 residents or (2) the greater of 50,000 residents or 10 percent of the population of the most populous city in the nominated area. Also, prior to amendment by the Act, the aggregate population of all urban zones could not exceed 750,000 persons. The population of a rural empowerment zone could not exceed 30,000 persons.

Whether urban or rural, an eligible area must have a condition of pervasive poverty, unemployment and general distress. In addition to being in general distress, the area must meet a three-part poverty rate test: (1) each of the census tracts in the area must have a poverty rate of at least 20 percent; (2) at least 90 percent of the census tracts must have a poverty rate of at least 25 percent; and (3)

Background

at least 50 percent of the census tracts must have a poverty rate of at least 35 percent. Census tracts with fewer than 2,000 people and at least 75-percent zoned for commercial or industrial use are treated as satisfying the 20- and 25-percent criteria. Each noncontiguous parcel located within an area must satisfy the poverty rate criteria separately.

An urban empowerment zone cannot exceed 20 square miles; rural empowerment areas cannot exceed 1,000 square miles. Urban areas must be located entirely within no more than two contiguous states and must have either a continuous boundary or be composed of not more than three noncontiguous parcels. Rural areas must not be located in more than three contiguous states.

Expanded eligibility criteria for new empowerment zones.—In addition to the two new empowerment zones authorized with the present-law criteria (see ¶ 371), 20 additional empowerment zones with expanded eligibility criteria are authorized. The Secretary of Housing and Urban development is authorized to designate up to 15 urban areas as new empowerment zones, while the Secretary of Agriculture is authorized to designate up to five new rural empowerment zones. The designations must be made after August 5, 1997 and before January 1, 1999.

Modified eligibility criteria. The eligibility criteria are expanded for these additional 20 empowerment zones. The Act indicates that the aggregate population limitation applicable to existing urban empowerment zones (including the two zones newly authorized under existing criteria) set forth in Code Sec. 1391(b)(2) does not apply to these empowerment zones. Thus, these zones are subject to the 750,000 population limitation rather than the one million limitation provided for the two new zones. These new zones may include areas within an Indian reservation. (A nomination for designation made by a reservation governing body is treated as a nomination by a state or local government.) In addition, previously designated enterprise communities may be included as one of these new zones, in contrast with the prohibition against double designations for existing empowerment zones and enterprise communities. To be eligible for designation, an area must satisfy modified poverty rate and size limitation requirements.

Poverty rate. An area meets the poverty rate requirement only if (a) the poverty rate for each census tract within the area is not less than 20 percent and (b) the poverty rate for at least 90 percent of the population census tracts within the area is not less than 25 percent. The 35-percent test under existing law does not apply to empowerment zones designated under this provision.

The special rule for determining the poverty rate for census tracts with small populations has been modified. A census tract with a population of less than 2,000 is treated as having a poverty rate of not less than 25 percent if (a) more than 75 percent of the tract is zoned commercial or industrial use and (b) the tract is contiguous with one or more census tracts that have a poverty rate of not less than 25 percent determined without regard to this clause. The current law requiring that at least 50 percent of the tract have a poverty rate of 35 percent or more does not apply.

Two exceptions from the poverty rate requirement have been provided. Up to three noncontiguous parcels that could be developed for commercial or industrial purposes that are located in a nominated area may be excluded from the poverty rate requirement. However, the aggregate area of these noncontiguous parcels can not exceed 2,000 acres. In addition, not more than one rural empowerment zone

may be designated without regard to the poverty rate requirement, provided that the area satisfies emigration criteria established by the Secretary of Agriculture.

Size limitations. Although the size limitations imposed upon empowerment zones generally apply to these new zones, certain aspects have been modified. The three noncontiguous developable parcels that are excludable from the poverty rate requirement, discussed above, are also not taken into account for purposes of the size limitations placed on empowerment zones. Thus, these parcels are not included in determining whether either the square-mile limitation (20 for urban zones and 1,000 for rural zones) or the limitation on the number of noncontiguous parcels has been exceeded. In addition, a special exception to the continuous boundary requirement has been provided for certain rural areas. If a population census tract in a rural area exceeds 1,000 square miles or includes a substantial amount of federal, state, or local government land, the excess square mileage or governmentally owned land may be excluded without violating the continuous boundary requirement.

Effective date. This provision is effective upon August 5, 1997, except that designations of new empowerment zones made as a result of amendments shall be made during the 180-day period beginning on August 5, 1997. No designation under an amendment shall take effect before January 1, 2000.

Act Sec. 952(a), adding Code Sec. 1391(g); Act Sec. 952(d), amending Code Sec. 1391(c), (e), and (f). Law at ¶ 5379. Committee Report at ¶ 10,735.

Tax Incentives for New Empowerment Zones

¶ 373

Background

Special tax incentives have been provided for distressed urban and rural areas that qualify as enterprise zones. Among the incentives provided are an empowerment zone employment credit (Code Sec. 1396) and an increased Code 179 expensing allowance (Code Sec. 1397A).

Employers that locate operations in an empowerment zone are allowed a credit against income tax liability based on the first $15,000 of qualified wages paid to employees that are residents of the empowerment zone and who perform substantially all of their work within the empowerment zone. The credit is calculated by multiplying the qualified wages by an applicable credit percentage. The applicable credit percentage is set at 20 percent through the year 2001. Beginning in 2002, the rate will be phased out by 5 percent each year, until it is reduced to zero in the year 2005.

The deduction allowed under the Code Sec. 179 expensing election is increased by a maximum of $20,000 for qualified zone property that is placed in service by an enterprise zone business. Thus, for property placed in service in 1997, the maximum amount allowed is $38,000: $18,000 allowed under Code Sec. 179, plus the additional $20,000 allowed under Code Sec. 1397A.

Tax incentives limited for newly authorized empowerment zones.— While the 20 newly authorized empowerment zones generally are eligible for the tax incentives provided for presently authorized zones, certain incentives have been modified or disallowed. The employment credit that is available to employers for wages paid to workers in an empowerment zone is not available for the 20 empowerment zones authorized under this provision. In addition, even though the increased Code Sec. 179 expensing limitation applies to these 20 new zones, the

increased limitation is not available for any parcels included in the empowerment zone under the special provision for noncontiguous developable parcels (see ¶ 372).

Effective date. This provision is generally effective upon August 5, 1997.

Act Sec. 952(b), adding Code Sec. 1396(e); Act Sec. 952(c), adding Code Sec. 1397A(a). Law at ¶ 5287 and 5385. Committee Report at ¶ 10,735.

Enterprise Zone Business

¶ 374

Background

To qualify for the increased expensing allowance and the tax-exempt bond financing provisions (but not the empowerment zone employment credit), businesses must be "enterprise zone businesses." A business qualifies as an enterprise zone business for the tax year if:

(1) in the case of a corporation or partnership, every trade or business of the entity is in the active conduct of a qualified business within an empowerment zone;

(2) at least 80 percent of its total gross income is derived from the active conduct of such trade or business;

(3) substantially all of its tangible property is used within an empowerment zone;

(4) substantially all of its intangible property is used in, and exclusively related to, the active conduct of the business;

(5) substantially all of its employees' services are performed within the empowerment zone;

(6) at least 35 percent of the employees are residents of the empowerment zone; and

(7) less than five percent of the average of the aggregate unadjusted bases of its property is attributable to either collectibles not held for sale to customers in the ordinary course of business or nonqualified financial property (such as debt or stock).

These criteria are modified for purposes of qualified enterprise zone bonds. The term empowerment zone is treated as including an enterprise zone as well. For purposes of determining whether the proceeds of the issuance are used for a qualified zone facility, enterprise zone business includes a business located in a zone or community that would qualify as an enterprise zone business if it were separately incorporated. For example, an outlet of a national retail chain could qualify under this definition.

Qualified businesses. Generally, any trade or business can qualify as an enterprise zone business. However, the rental of tangible personal property may be a qualified business only if substantially all of the rental of the property is by enterprise zone businesses or by residents of an empowerment zone. Any trade or business that consists primarily of the development or holding of intangibles for sale or license cannot be an enterprise zone business (Code Sec. 1397B(d)).

Requirements for qualification as an enterprise zone business relaxed.—In order to qualify as an enterprise zone business, and thereby become

eligible for tax incentives available only to such businesses, a business must meet criteria designed to ensure that it is actively conducting business within an empowerment zone (or enterprise community for purposes of qualified enterprise zone bonds). Among these criteria are requirements regarding the percentage of gross income derived from the conduct of the business within the empowerment zone, the use of the business's property and employee services within the zone, and the type of business operated.

The requirements for qualification as an enterprise zone business have been modified for all empowerment zones and enterprise communities, including the new zones authorized under the Act (see ¶ 371 and 372). The requirement that 80 percent of the business's total gross income be derived from the conduct of business within the empowerment zone is relaxed to a 50-percent requirement. The "substantially all" test that required that substantially all of the business's use of tangible and intangible property and employee services take place within the zone is replaced with a less stringent "substantial portion" of use test. In addition, the requirement that the use of intangible assets be "exclusively related" to the business has been eliminated.

The remaining criteria for enterprise zone businesses are unchanged and remain applicable.

Property rental rules. A business engaging in renting tangible property to others can qualify as an enterprise zone business if at least 50 percent of the rental of such property is by residents of an empowerment zone or community or by an enterprise zone business. Again, this relaxes the requirement from a "substantially all" test. An enterprise zone business that leases commercial property to others is entitled to rely on the lessee's certification that the lessee is an enterprise zone business.

Businesses straddling census tract lines. If a business uses property located within an empowerment zone, as well as property located outside of the empowerment zone, all business activities, including services performed by employees and use of tangible and intangible property, will be considered to occur within the empowerment zone if two conditions are met. First, the amount of real property located within the zone must be substantial compared to that located outside of the zone. Second, the real property within the zone must be contiguous with all or part of the real property located outside of the zone.

Effective dates. The modifications apply to tax years beginning on or after August 5, 1997. For purposes of enterprise zone facility bonds, these modifications apply to obligations issued after August 5, 1997.

Act Sec. 956(a), amending Code Sec. 1397B(b), (c), and (d) and adding Code Sec. 1397B(f). Act Sec. 956(b). Law at ¶ 5389. Committee Report at ¶ 10,735.

Alaska and Hawaii

¶ 375

Background

An area nominated for designation as an empowerment zone or enterprise community must meet certain eligibility criteria. The eligibility criteria include specified population limitations, geographic size limitations and poverty-rate criteria for census tracts within the empowerment zone or enterprise community. Prior to the Taxpayer Relief Act of 1997, nominated areas in Alaska and Hawaii were

Background

subject to the same eligibility criteria that applied to nominated areas in other states.

Special eligibility rules for Alaska and Hawaii.—The eligibility criteria that must be met by an area nominated for designation as an empowerment zone or enterprise community are modified for nominated areas located in Alaska and Hawaii. Nominated areas in Alaska and Hawaii are not subject to the general size limitation and poverty-rate criteria. Instead, a nominated area in Alaska or Hawaii will be eligible for designation as an empowerment zone or enterprise community if, for each census tract or block group within the area, at least 20 percent of the families have income that is 50 percent or less of the statewide median family income. Statewide median family income is determined under the Code Sec. 143 rules that define certain mortgage bonds.

Effective date. The special eligibility criteria for Alaska and Hawaii are effective on August 5, 1997.

Act Sec. 954, adding Code Sec. 1392(d). Law at ¶ 5381. Committee Report at ¶ 10,735.

Facility Bond Cap

¶ 377

Background

Enterprise zone financing bonds, a type of tax-exempt facility bond, can be used to finance property located in an empowerment zone or enterprise community. To qualify as an enterprise zone financing bond, the issuance must be designated as such and at least 95 percent of the net proceeds of the issuance must be used to finance qualified zone property that is used primarily by a qualified zone business.

Because these bonds are considered private activity bonds, they are subject to the volume cap. In addition to the volume limitations applicable to all private activity bonds, there are specific limitations on the aggregate amount of enterprise financing zone bonds that can be issued. The aggregate amount of enterprise financing zone bonds per qualified zone business may not exceed $3 million of each zone. Additionally, the total outstanding qualified zone financing for each qualified zone business cannot exceed $20 million for all zones.

Volume cap not applicable to new enterprise zone facility bonds.—The Act creates a new category of financing bonds—empowerment zone bonds. Empowerment zone bonds are similar to the existing enterprise zone bonds in that they include any bond issued as part of an issue where at least 95 percent of the proceeds are used to provide an enterprise zone facility. However, for purposes of determining what constitutes an enterprise zone facility, only the 20 newly authorized empowerment zones are considered when applying the definitions of enterprise zone business and qualified zone property.

The new empowerment zone bonds differ from enterprise zone bonds in two significant ways. They are not treated as private activity bonds under Code Sec. 146 and, therefore, are not subject to the volume cap imposed on issuances of private activity bonds. In addition, they are not subject to the $3 million per

empowerment zone or enterprise community and $20 million total for all empowerment zones or enterprise communities limitations on issue size imposed upon enterprise bonds. The new empowerment zone bonds issued are not to be taken into account to determine whether the enterprise facility bond limitation has been exceeded.

Designation and amount. Each empowerment zone bond issuance must be so designated by the state or local government that nominated the empowerment area for which the bonds are issued. Although the existing enterprise zone bond limitations do not apply, there is a limitation on the maximum amount of empowerment zone bonds that can be issued per empowerment zone. The maximum aggregate face amount of bonds issued for a rural empowerment zone can not exceed $60 million. For urban zones with a population under 100,000, the maximum amount is $130 million per zone; this maximum is increased to $230 million per zone for zones with a population of 100,000 or more. Current refunding is not taken into account in determining the maximum amounts so long as the amount of the refunding bond is less than the outstanding amount of the refunded bond and the refunded bond is redeemed no later than 90 days after the refunding bonds is issued.

Effective date. This provision applies to obligations issued after August 5, 1997.

Act Sec. 953(a), adding Code Sec. 1394(f). Act Sec. 953(b). Law at ¶ 5383. Committee Report at ¶ 10,735.

Modifications to Qualified Zone Business

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Background

To qualify for the increased expensing allowance and the tax-exempt bond financing provisions (but not the empowerment zone employment credit), businesses must be "enterprise zone businesses." A business qualifies as an enterprise zone business for the tax year if:

(1) in the case of a corporation or partnership, every trade or business of the entity is in the active conduct of a qualified business within an empowerment zone;

(2) at least 80 percent of its total gross income is derived from the active conduct of such trade or business;

(3) substantially all of its tangible property is used within an empowerment zone;

(4) substantially all of its intangible property is used in, and exclusively related to, the active conduct of the business;

(5) substantially all of its employees' services are performed within the empowerment zone;

(6) at least 35 percent of the employees are residents of the empowerment zone; and

(7) less than five percent of the average of the aggregate unadjusted bases of its property is attributable to either collectibles not held for sale to customers in the ordinary course of business or nonqualified financial property (such as debt or stock).

Background

Generally, any trade or business can qualify as an enterprise zone business. However, the rental of tangible personal property may be a qualified business only if substantially all of the rental of the property is by enterprise zone businesses or by residents of an empowerment zone.

Definition of enterprise zone business for qualified enterprise/empowerment zone bonds.—The Code Sec. 1397B definition of enterprise zone business is modified for purposes of determining eligibility for tax-exempt bond financing with either existing enterprise bonds or the newly created empowerment zone bonds. In addition to continuing the present law modifications that the term empowerment zone includes enterprise communities and that an enterprise zone business includes any trade or business that would qualify if separately incorporated, two additional modifications are provided.

Startup period. The requirement that 95 percent or more of the bond issuance proceeds be used by an enterprise zone business is waived during a startup period. The startup period is defined with respect to when property is provided by a bond issuance. The startup period can not be longer than the beginning of the first taxable year after the later of either (1) the date of the bond issuance providing the property or (2) the date the property was placed in service. In no event can the startup be later than three years after the date of the bond issuance. To qualify for such a waiver, it must be reasonably expected from the outset that the business will qualify as an enterprise zone business at the end of the startup period, and the business must make bona fide efforts to meet the enterprise zone business definition.

Reduced residency requirements. For purposes of qualified enterprise/empowerment zone bonds, all requirements, except that at least 35 percent of the employees of the business be residents of an empowerment zone or enterprise community, are waived after a testing period is completed. The testing period is the first three tax years beginning after the startup period.

Effective date. This provision applies to obligations issued after August 5, 1997.

Act Sec. 955(a), amending Code Sec. 1394(b)(3); Act Sec. 955(c). Law at ¶ 5383. Committee Report at ¶ 10,735.

Modifications to Qualified Zone Property

¶ 379

Background

Qualified zone property is defined as depreciable tangible property that meets certain acquisition and use tests. The property must have been acquired by the taxpayer after an area has been designated as an empowerment zone or enterprise zone. The original use of the property must have been in an empowerment zone. Substantially all of the property's use must be in an empowerment zone and in the active conduct of a qualified trade or business.

Where the property is substantially renovated by the taxpayer, the requirement that the property be acquired after the area was designated as an empowerment zone and originally used in an empowerment zone is waived. However, during any 24-month period after the designation, the additions to the taxpayer's basis in

Background

the property must exceed the greater of 100 percent of the taxpayer's basis in the property at the beginning of the period or $5,000.

Definition of qualified property modified for bond purposes.—For purposes of issuing enterprise zone or empowerment zone bonds, the requirements for qualified zone property are relaxed with respect to substantial renovations. Under present law, property that is substantially renovated by the taxpayer need not have been acquired by the taxpayer after the area had been designated as an empowerment zone or enterprise community and need not have been originally used by the taxpayer within the zone. However, the amount that must be expended on renovations during each two-year period is reduced. Under the relaxed rule, the additions to the taxpayer's basis during any 24-month period after the zone or community designation must exceed the greater of 15 percent of the taxpayer's basis at the beginning of the period or $5,000.

Effective date. This provision applies to obligations issued after August 5, 1997.

Act Sec. 955(b), amending Code Sec. 1394(b)(2); Act Sec. 955(c). Law at ¶ 5383. Committee Report at ¶ 10,735.

DISTRICT OF COLUMBIA TAX INCENTIVES

District of Columbia Enterprise Zone

¶ 381

Background

In 1994, portions of the District of Columbia were designated as an enterprise community pursuant to Code Sec. 1391. As an enterprise community, qualified businesses operating within those portions of the District of Columbia became eligible to finance property with tax-exempt facility bonds under Code Sec. 1394. Although enterprise communities are only eligible for the exempt facility bonds incentive, empowerment zones are eligible for two additional tax incentives. Under Code Sec. 1397A, qualifying empowerment zone businesses are entitled to an increase in the Code Sec. 179 expensing limitation of up to $20,000, and qualifying empowerment zone employers under Code Sec. 1396 are entitled to a 20-percent credit for the first $15,000 of wages paid to zone residents who also work in the zone. Under Code Sec. 1391(d), the designations of areas as enterprise communities or empowerment zones was to remain in effect for a 10-year period unless an earlier termination date was provided in the document nominating the area for designation as an enterprise community or an empowerment zone or the designation was revoked.

Under prior law, the District of Columbia was not specifically entitled to any tax incentives other than those associated with the designation as an enterprise community. Moreover, there was no special capital gains rate or first-time homebuyer credit which applied specifically to the District of Columbia.

Establishment of District of Columbia Enterprise Zone.—In addition to the census tracts located in the District of Columbia that are already part of an

enterprise community under Code Sec. 1391, all other census tracts located in the District of Columbia that have a poverty rate of 20 percent or higher are now designated as the District of Columbia Enterprise Zone ("D.C. Zone"). The D.C. Zone is treated as an empowerment zone for purposes of Code Secs. 1391 through 1397C. The designation of the D.C. Zone applies for the period of January 1, 1998, through December 31, 2002. The designation of certain census tracts located in the District of Columbia as enterprise communities prior to the designation of the D.C. Zone also terminates on December 31, 2002.

Application of empowerment zone employment credit. The empowerment zone employment credit under Code Sec. 1396 is now available to employers located in the D.C. Zone, with certain modifications. Although Code Sec. 1396(d)(1)(B) requires qualified zone employees to reside in the empowerment zone, for purposes of the D.C. Zone, the credit is available with respect to all employees whose principal place of abode is in the District of Columbia, but not necessarily in the D.C. Zone. Further, the applicable wage credit rate under Code Sec. 1396(b) remains at 20 percent for the period 1998 through 2002. The wage rate does not decrease to 15 percent in the year 2002 as it does for other empowerment zones. The applicable wage rate for the D.C. Zone applies with respect to qualified zone employees, as determined by treating no area other than the D.C. Zone as an empowerment zone or enterprise community. Moreover, no portion of the unused business credit that is attributable to the D.C. Zone employment credit may be carried back to a tax year ending before August 5, 1997.

Application of enterprise zone business definition to the D.C. Zone. The definitions of qualified business entity in Code Sec. 1397B(b) and qualified proprietorship in Code Sec. 1397B(c) are applied, for purposes of the D.C. Zone, without regard to the requirement for other empowerment zones that at least 35 percent of the entity's employees must be residents of the empowerment zone.

Effective date. The District of Columbia tax incentive provisions are effective on August 5, 1997.

Act Sec. 701(a), adding Code Sec. 1400; Act Sec. 701(b)(1), adding Code Sec. 39(d)(8); Act Sec. 701(c) and (d). Law at ¶ 5017 and 5395. Committee Report at ¶ 10,465.

Economic Development Bonds

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Limit on amount of tax-exempt economic development bonds.—For purposes of the District of Columbia Enterprise Zone ("D.C. Zone"), the limitation on the amount of qualified enterprise zone bonds per qualified enterprise zone business under Code Sec. 1394(c)(1)(A) has been increased from $3 million per zone or community to $15 million. The increase in the limitation applies to bonds issued during the period of January 1, 1998, through December 31, 2002.

Effective date. The District of Columbia tax incentive provisions are effective on August 5, 1997.

Act Sec. 701(a), adding Code Sec. 1400A; Act Sec. 701(d). Law at ¶ 5397. Committee Report at ¶ 10,465.

Zero-Percent Capital Gains Rate

¶ 385

Zero-percent capital gains rate.—A capital gains rate of zero percent applies to qualified capital gains from the sale or exchange of District of Columbia Enterprise Zone ("D.C. Zone") assets held for more than five years. A D.C. Zone asset includes D.C. Zone business stock, D.C. Zone partnership interests, and D.C. Zone business property.

D.C. Zone business stock. D.C. Zone business stock is any stock in a domestic corporation originally issued after December 31, 1997, as long as:

(1) the stock is acquired before January 1, 2003, by the taxpayer at its original issue solely in exchange for cash;

(2) the corporation was a D.C. Zone business at the time the stock was issued or, in the case of a new corporation, the corporation was being organized for purposes of being a D.C. Zone business; and

(3) during substantially all of the taxpayer's holding period of the stock, the corporation qualified as a D.C. Zone business.

Caution. A rule similar to the rule of Code Sec. 1202(c)(3), that treats stock acquired in certain redemptions as failing to qualify as small business stock, applies.

D.C. Zone partnership interest. A D.C. Zone partnership interest is any capital or profits interest in a domestic partnership that is originally issued after December 31, 1997, if:

(1) the interest is acquired before January 1, 2003, by the taxpayer from the partnership solely in exchange for cash;

(2) the partnership was a D.C. Zone business at the time the interest was acquired or, in the case of a new partnership, the partnership was being organized for purposes of being a D.C. Zone business; and

(3) during substantially all of the taxpayer's holding period for the interest, the partnership qualified as a D.C. Zone business.

Caution. A rule similar to the rule that treats stock acquired by a corporation in a significant redemption as failing to qualify as D.C. Zone business stock (see above) will apply to D.C. Zone partnership interests.

D.C. Zone business property. D.C. Zone business property consists of tangible property purchased by the taxpayer after December 31, 1997, and before January 1, 2003. The original use of the property in the D.C. Zone must commence with the taxpayer, and substantially all of the property's use must be in the taxpayer's D.C. Zone business during substantially all of the taxpayer's holding period for the property.

With respect to business property (and any land on which the property is located) that is substantially improved by the taxpayer before January 1, 2003, the property need not be acquired by the taxpayer after December 31, 1997, and the original use of the property need not commence with the taxpayer in order to be treated as D.C. Zone business property. A property is substantially improved if, during any 24-month period beginning after December 31, 1997, additions to basis of the property in the hands of the taxpayer exceed the greater of (1) an amount

equal to the property's adjusted basis at the beginning of the 24-month period in the hands of the taxpayer or (2) $5,000.

Subsequent purchasers. A D.C. Zone asset also includes property that was a qualified D.C. Zone asset in the hands of a prior owner, provided that, at the time of acquisition and during substantially all of the subsequent purchaser's holding period (1) in the case of D.C. Zone business property, substantially all of the use of the property is in a qualified D.C. Zone business or (2) in the case of D.C. Zone business stock or D.C. Zone partnership interests, the property is an ownership interest in a qualified D.C. Zone business.

Five-year safe harbor. If property or an ownership interest ceases to be a D.C. Zone asset after the five-year period beginning on the date the taxpayer acquired the property because the property is no longer used in a D.C. Zone business or because the corporation or partnership no longer qualifies as a D.C. Zone business, that property continues to be treated as a D.C. Zone asset. However, the amount of the gain eligible for the zero percent capital gain rate upon the sale or exchange of the property cannot exceed the amount that would be qualified capital gain had the property been sold on the date the property ceased to be a D.C. Zone asset.

D.C. Zone business. A D.C. Zone business is any entity that is an enterprise zone business, as defined in Code Sec. 1397B, with certain modifications. The requirement that at least 35 percent of the entity's employees be residents of the empowerment zone does not apply. The requirement that at least 50 percent of the total gross income of the entity be derived from the active conduct of a qualified business within the empowerment zone is increased to 80 percent. Finally, the determination of whether the entity is an enterprise zone business is made by treating no area other than the D.C. Zone as an empowerment zone or enterprise community.

Definition of D.C. Zone for zero capital gains rate provision. For purposes of applying the zero percent capital gains rate rule, the D.C. Zone includes all census tracts located in the District of Columbia that have a poverty rate of 10 percent or higher.

Qualified capital gain. A qualified capital gain is any gain recognized on the sale or exchange of a capital asset or property used in a trade or business as defined in Code Sec. 1231(b) (for example, depreciable property and real property used in the business and not held for sale to customers). Gain attributable to periods before January 1, 1998, or after December 31, 2007, is not qualified capital gain. Qualified capital gain does not include gain that would be treated as ordinary income under the Code Sec. 1245 or 1250 depreciation recapture provisions if Code Sec. 1250 applied to all depreciation rather than the additional depreciation.

Gain attributable to real property or an intangible asset that is not an integral part of a D.C. Zone business is not qualified capital gain. Qualified capital gain also does not include gain attributable, directly or indirectly, in whole or in part, to a transaction with a related person as described in Code Sec. 267(b) or 707(b)(1). Related parties include, but are not limited to, family members, a corporation and an individual who owns more than 50 percent in value of the corporation either directly or indirectly, a partnership and a person owning more than a 50 percent capital or profits interest in the partnership, two partnerships in which the same persons own more than 50 percent of the capital or profits interests either directly or indirectly, and a fiduciary and a beneficiary of a trust.

With respect to the sale or exchange of an interest in a partnership or stock in an S corporation that is a D.C. Zone business during substantially all of the period

the taxpayer held the interest or stock, the amount of qualified capital gain is determined without regard to (1) gain attributable to real property or an intangible asset that is not an integral part of a D.C. Zone business and (2) gain attributable to periods before January 1, 1998, or after December 31, 2007.

Certain other applicable rules. Rules similar to those of Code Sec. 1202(g), relating to the treatment of pass-through entities; Code Sec. 1202(h), relating to certain tax-free and other transfers; Code Sec. 1202(i)(2), relating to the treatment of certain contributions to capital; and Code Sec. 1202(j), relating to the treatment of certain short positions, apply.

Effective date. The District of Columbia tax incentive provisions are effective on August 5, 1997.

Act Sec. 701(a), adding Code Sec. 1400B; Act Sec. 701(d). Law at ¶ 5399. Committee Report at ¶ 10,465.

First-Time Homebuyer Credit

¶ 387

First-time homebuyer credit for the District of Columbia.—A first-time homebuyer of a principal residence in the District of Columbia is entitled to a tax credit of up to $5,000 of the amount of the purchase price of the residence. The amount of the credit is phased out for individual taxpayers with modified adjusted gross income (AGI) between $70,000 and $90,000 ($110,000 and $130,000 for joint filers).

In computing the credit, the amount of the credit is reduced by an amount that bears the same ratio to $5,000 as the excess of the taxpayer's modified AGI for the tax year over $70,000 ($110,000 for joint filers) bears to $20,000. The amount cannot be reduced below zero. In other words, for every $1,000 of modified adjusted gross income above $70,000 for an individual ($110,000 for joint filers), the credit is reduced by $250.

The amount of the reduction can be determined by applying the following formula:

$$\$5{,}000 \times \frac{\text{Modified AGI} - \$70{,}000}{\$20{,}000}$$

For joint return filers, the $70,000 amount in the above formula would be replaced with $110,000.

> **Example.** Richard and Melanie Stevens purchase their first home in the District of Columbia for $200,000. Their modified adjusted gross income for the year is $120,000. The maximum credit of $5,000 must be reduced to account for their excess modified AGI over $110,000. Thus, the amount of their credit is equal to $5,000 − $5,000 × (($120,000 − $110,000) ÷ $20,000), or $2,500.

An individual's modified AGI is AGI plus any amount excluded from income under:

(1) the exclusion for foreign earned income and housing (Code Sec. 911);

(2) the exclusion for income from sources within Guam, American Samoa, and the Northern Mariana Islands (Code Sec. 931); and

(3) the exclusion for income from sources within Puerto Rico (Code Sec. 933).

An individual qualifies as a first-time homebuyer if that individual and that individual's spouse had no present ownership interest in a principal residence in the District of Columbia during the one-year period ending on the date of the acquisition of the residence. Moreover, if an individual is treated as a first-time homebuyer with respect to a principal residence, that individual cannot be treated as a first-time homebuyer with respect to any other principal residence. A principal residence has the same meaning for purposes of the District of Columbia first-time homebuyer credit as it does in Code Sec. 121 for purposes of the exclusion of up to $250,000 of gain on the sale of a principal residence ($500,000 for joint filers). The credit is treated as a nonrefundable personal credit, and any excess credit over the Code Sec. 26(a) limitation can be carried over to the succeeding tax year.

For married taxpayers filing separately, the maximum amount of the credit is $2,500 each. The IRS has been authorized to issue regulations to determine the allocation of the credit among unmarried individuals who purchase a principal residence together in the District. However, the total amount of credit allowed to all such individuals cannot exceed $5,000.

The principal residence cannot be acquired from a person whose relationship to the purchaser would result in a disallowance of losses under the related taxpayer rules of Code Sec. 267 or the rules for the sale or exchange of property with respect to controlled partnerships under Code Sec. 707(b). However, in applying the relationships listed in Code Sec. 267(b) and the constructive ownership of stock rules of Code Sec. 267(c), a family of an individual only includes a spouse, ancestors, and lineal descendants; it does not include brothers and sisters as provided in Code Sec. 267(c)(4). Moreover, the basis of the principal residence in the hands of the purchaser cannot be determined, in whole or in part, by reference to the adjusted basis of the residence in the hands of the seller or under Code Sec. 1014(a), relating to the basis of property acquired from a decedent. Furthermore, a residence that is constructed by the taxpayer is treated as purchased by the taxpayer.

The purchase price is equal to the adjusted basis of the principal residence on the date of acquisition. The basis of the principal residence is reduced by the amount of the first-time homebuyer credit allowed. If the IRS requires information reporting under Code Sec. 6045 to verify the eligibility of taxpayers for the first-time homebuyer credit, the exception under Code Sec. 6045(e)(5) for the sale or exchange of certain principal residences does not apply.

Caution. The District of Columbia first-time homebuyer credit does not apply to property that is purchased after December 31, 2000.

Effective date. The District of Columbia tax incentive provisions are effective on August 5, 1997.

Act Sec. 701(a), adding Code Sec. 1400C; Act Sec. 701(b)(2), amending Code Sec. 1016(a)(25) and (26) and adding (27); Act Sec. 701(d). Law at ¶ 5317 and 5401. Committee Report at ¶ 10,465.

[illegible]

Chapter 4

Partnerships and S Corporations

PUBLICLY TRADED PARTNERSHIPS

Election to Continue Partnership Status

¶ 401

Background

A publicly traded partnership (PTP) is a partnership whose interests are (1) traded on an established securities market or (2) readily traded on a secondary market or the substantial equivalent. Code Sec. 7704, enacted as part of the Omnibus Budget Reconciliation Act of 1987 (P.L. 100-203), generally treats publicly traded partnerships as corporations for federal tax purposes (Code Sec. 7704(a)). A partnership may be exempt from treatment as a corporation if 90 percent of its gross income is passive-type income, such as interest, dividends, real property rents, gains from the disposition of real property, and similar income or gains.

When the PTP rules were enacted in 1987, a 10-year grandfather rule exempted certain existing partnerships from corporate treatment. The grandfather exception applies until tax years beginning after December 31, 1997. An existing PTP is generally defined as any partnership that was actually a PTP on December 17, 1987, or that had appropriately filed a federal registration statement or a state application indicating its intent to become a PTP on or before December 17, 1987.

An existing PTP qualifying under the grandfather rule will cease to be treated as an existing PTP as of the first day after December 17, 1987, that it adds a substantial new line of business (Reg. § 1.7704-2; P.L. 100-203, Act Sec. 10211(c)(2)(B)). If the PTP's grandfathered status ceases to apply, and if the passive-type income exception is also inapplicable, then the PTP is treated as a corporation for federal tax purposes.

From a nontax perspective, the process of converting from a publicly traded partnership to a corporation is costly and time-consuming, involving consultations with investment bankers, securities regulators and tax lawyers, as well as the cost of appraisals and the burden of multiple filings with federal and state securities agencies. Also, the value of PTP interests may be adversely affected by a conversion to corporate status.

Grandfathered publicly traded partnership may elect to continue partnership status.—A publicly traded partnership (PTP) that is currently exempt from corporate tax under the grandfather exception may elect to continue its partnership status beyond the original 10-year window. The grandfather exception generally provides that a PTP will not be taxed as a corporation in tax years beginning before 1998 if the partnership existed as a PTP or is treated as having existed as a PTP on December 17, 1987, and does not add a substantial new line of business during the 10-year window. The grandfather exception is scheduled to expire for tax years beginning after December 31, 1997 (Act Sec. 10211(c) of P.L. 100-203). A grandfathered PTP electing to continue its partnership status must agree to pay an annual 3.5-percent tax on any income from active businesses.

Electing 1987 partnership. A grandfathered PTP may elect to continue its partnership status as an "electing 1987 partnership." An electing 1987 partnership is subject to a 3.5-percent annual tax on gross income from the active conduct of any trades or businesses (Code Sec. 7704(g)(3)(A)). The 3.5-percent tax imposed under this provision cannot be offset by any tax credits (Code Sec. 7704(g)(3)(C)).

An electing 1987 partnership will not be treated as a corporation for federal tax purposes (Code Sec. 7704(g)(1)).

In order to be an electing 1987 partnership, a PTP must fulfill the following three requirements: (1) the entity must be an "existing partnership" (as defined by Act Sec. 10211(c)(2) of the Revenue Reconciliation Act of 1987, P.L. 100-203); (2) Code Sec. 7704(a) has not applied (and without regard to Code Sec. 7704(c)(1) would not have applied) to the partnership for all prior tax years beginning after December 31, 1987 and before January 1, 1998; and (3) the partnership properly elects to be subject to this provision and consents to the application of the 3.5 percent tax for its first tax year beginning after December 31, 1997. Note that partnerships that have been exempt from corporate treatment solely due to the passive-type income exception under Code Sec. 7704(c)(1) do not qualify as electing 1987 partnerships.

New line of business will terminate status. An electing 1987 partnership, like other grandfathered partnerships under the Code Sec. 7704 provisions, will lose its partnership status as of the first day after December 31, 1997 on which the partnership adds a substantial new line of business (Code Sec. 7704(g)(2)).

Gross income of electing partnership. For an electing 1987 partnership holding an interest in another partnership, gross income includes the partnership's distributive share of any gross income from the other partnership's active conduct of a trade or business. A similar rule applies in the case of lower-tier partnerships (Code Sec. 7704(g)(3)(B)).

Election may be revoked. The election, once made, applies to the tax year for which it has been made and for all subsequent tax years, until revoked by the electing partnership. IRS consent is not needed to revoke the election. However, once revoked, the election cannot be reinstated (Code Sec. 7704(g)(4)).

Effective date. These provisions are effective for tax years beginning after December 31, 1997.

Act Sec. 964(a), adding Code Sec. 7704(g); Act Sec. 964(b). Law at ¶ 5749. Committee Report at ¶ 10,850.

DISTRIBUTIONS OF PARTNERSHIP PROPERTY

Allocation of Basis

¶ 403

Background

A carryover basis rule generally applies to property distributed to a partner other than in liquidation of the partner's partnership interest, subject to a limitation (Code Sec. 732). In a nonliquidating distribution, the distributee partner's basis in the property is equal to the partnership's adjusted basis in the property immediately before the distribution, but not to exceed the partner's adjusted basis in the partner's partnership interest (reduced by any money that may have been distributed in the same transaction).

A substituted basis rule generally applies to property distributed to a partner in liquidation of the partner's interest. Thus, the total basis of all property received in a liquidating distribution is equal to the partner's adjusted basis in the partner's partnership interest immediately before the distribution (as reduced by any money that may have also been distributed in the same transaction).

Background

When multiple properties are distributed by a partnership to a partner in a liquidating distribution, or when the limitation on carryover basis applies, an allocation provision is needed in order to assign a portion of the partner's basis in the partner's partnership interest to each distributed asset. Prior to amendment by the Act, Code Sec. 732(c)(1) first allocated basis to unrealized receivables and inventory items (as defined by Code Sec. 751) in an amount equal to the partnership's adjusted basis in each such property and, to the extent of any remaining partner basis, then among any other distributed properties in proportion to their adjusted bases to the partnership (former Code Sec. 732(c)(2)).

Since this allocation provision failed to take into account the actual fair market values of the partnership's distributed assets, a partner was indirectly encouraged to engage in tax planning when receiving distributed property pursuant to a liquidation of the partner's interest. Under prior law, following a liquidating distribution, the distributee partner could have a basis in the distributed property (other than unrealized receivables and inventory) that exceeded the partnership's own basis in that property. This prior rule led to numerous basis shifting transactions in which basis was allocated so as to increase basis artificially, giving rise to either inflated depreciation deductions or artificially large losses.

Distributed property basis allocation changes to fair market value standard.—A partner's substituted basis in distributed partnership property will be allocated among multiple properties based on the unrealized appreciation or depreciation of the distributed properties. Allocations based on the partnership's proportionate basis in the distributed properties will no longer be used. In a substituted basis transaction, distributed properties assume the same basis as the partner's basis in his partnership interest. Substituted basis is used when the partner's interest is liquidated. Substituted basis also applies when a partner receiving a nonliquidating distribution cannot carry over the partnership's basis in the property because the carryover basis exceeds the partner's basis in the partnership.

Allocate first to unrealized receivables and inventory. A distributee partner's substituted basis is first allocated to any unrealized receivables or inventory items that were distributed as part of the transaction. Basis is allocated to unrealized receivables and inventory to the extent of the partnership's basis in these items (Code Sec. 732(c)(1)(A)). Unrealized receivables and inventory are defined in Code Sec. 751(c) and Code Sec. 751(d)(2), respectively.

Insufficient basis to cover unrealized receivables and inventory. If the partner does not have enough available basis to cover the full amount of the partnership's basis in unrealized receivables and inventory, the shortfall in available basis must be allocated among the unrealized receivables and inventory. The difference between the partnership's basis in the unrealized receivables and inventory and the partner's substituted basis available for allocation is treated as a basis "decrease." The decrease is allocated first to properties with unrealized depreciation (Code Sec. 732(c)(3)(A)). This formula is designed to reduce the partner's basis in depreciated property, and will prevent excessive losses when the property is disposed of.

Other distributed properties. Basis remaining after allocations to inventory and unrealized receivables is allocated to other properties to the extent of the partnership's basis in those properties. After this amount, basis increases are

allocated first to properties with unrealized appreciation. A decrease in basis is required if the partner does not have sufficient basis to allocate the partnership's full basis in the properties.

Basis decrease formula. The basis decrease is first allocated to property with unrealized depreciation to the extent of the unrealized depreciation in each property (Code Sec. 732(c)(3)(A)). If insufficient basis is available to decrease the partner's basis by the full amount of depreciation in each property, the available basis is allocated to the properties in proportion to their respective amounts of unrealized depreciation. Any remaining decrease is allocated to the properties in proportion to their respective adjusted bases (Code Sec. 732(c)(3)(B)). The decrease made in proportion to the properties' bases is calculated taking into account any basis decreases made to depreciated property.

> **Example (1).** The Lindisfarne Partnership, which has two assets, C and D, distributes them both in liquidation to a partner, Sabina, whose basis in her partnership interest is $2000. Neither asset is inventory or an unrealized receivable. Asset C has a basis to the partnership of $1500 and a fair market value of $1500, and asset D has a basis to the partnership of $1500 and a fair market value of $500.
>
> Under the new provisions, Sabina's basis is first allocated to the extent of the partnership's basis in each distributed property, or $1500 to each distributed property, for a total of $3000. However, since Sabina's basis in her interest is only $2000, a downward adjustment of $1000 ($3000 – $2000) is required. The entire amount of the $1000 downward adjustment is allocated to asset D due to its unrealized appreciation, reducing its basis to $500. Thus, the basis of asset C is $1500 in Sabina's hands, and the basis of property D is $500 in Sabina's hands.

Basis increase. Any basis adjustment remaining after the partnership's basis has been fully carried over is first allocated among those properties with unrealized appreciation to the full extent of each property's unrealized appreciation. Allocations in an amount less than the full appreciation are allocated in proportion to the properties' respective amounts of unrealized appreciation. To the extent that the increase is not fully allocated at this point, it is allocated in proportion to the properties' respective fair market values (Code Sec. 732(c)(2)).

> **Example (2).** The Wadsworth Partnership makes a liquidating distribution of asset A and asset B to a partner, Sean. Sean's basis in his partnership interest is $5500. Neither asset is inventory or unrealized receivables. Asset A has a basis to the partnership of $500 and a fair market value of $4000, and asset B has a basis to the partnership of $1000 and a fair market value of $1000.
>
> Sean's basis is first allocated to asset A in the amount of $500 and to asset B in the amount of $1000 (their adjusted bases to the partnership).
>
> The remaining basis adjustment is an increase of $4000 (that is, Sean's $5500 basis minus the partnership's total basis in the distributed assets of $1500). Sean's remaining basis is next allocated to asset A in the amount of $3500, its unrealized appreciation. However, there is no basis allocation to asset B attributable to unrealized appreciation because its fair market value equals the partnership's adjusted basis.

The final basis adjustment of $500 (that is, $4000 – $3500) is allocated in the ratio of the two assets' fair market values—$400 to asset A (for a total basis of $4400) and $100 to asset B (for a total basis of $1100).

PRACTICAL ANALYSIS. Chuck Levun of Levun, Goodman & Cohen, Northbrook, Illinois, notes that Section 1061 of the Taxpayer Relief Act of 1997 changes the manner in which a partner's basis in his partnership interest is allocated among multiple properties distributed by the partnership to a partner whose partnership interest is being completely liquidated. The basic import of the change is for the basis allocation to take account of the relative unrealized appreciation or unrealized depreciation contained in the distributed assets, when there is a difference between a partner's outside basis for his partnership interest and his share of the inside basis of the partnership assets distributed to him. For distributions occurring on or prior to August 5, 1997, basically the law had been to allocate basis to distributed properties in proportion to their relative adjusted bases in the hands of the partnership.

For example, assume a partner had a $1,800 basis for his partnership interest and receives a distribution from the partnership in liquidation of his interest consisting of Investment Property A, with a basis in the hands of the partnership of $300 and a fair market value of $1,200, and Investment Property B, with a basis in the hands of the partnership of $700 and a fair market value of $800. (This example does not contain a distribution of unrealized receivables or inventory items because under *both* old and new law the partner's basis is first allocated to these items to the extent of the partnership's basis immediately prior to the distribution). Under old law, Investment Properties A and B would take a basis in the hands of the distributee of $540 and $1,260, respectively (i.e., based upon their respective 30 percent and 70 percent relative adjusted bases in the hands of the partnership, multiplied by the partner's $1,800 basis for his partnership interest). Under new law, the basis allocation would be made as follows:

	Investment Property A	*Investment Property B*
First $1,000 of basis—equal to partnership's adjusted basis	$ 300	$700
Remaining $800 of basis—based upon relative unrealized appreciation in the distributed properties ($900 vs. $100)	720	80
	$1,020	$780

PRACTICAL ANALYSIS. Andrew N. Berg, of Debevoise & Plimpton, New York, N.Y., remarks that this section of the Act targets an abuse sometimes referred to as the "million dollar pencil." Prior to its amendment by the Act, Code Sec. 732(c) apportioned a partner's basis in its partnership interest (after

accounting for hot assets and cash) among assets received by that partner in liquidation of its partnership interest in proportion to the adjusted bases of such assets. Since this apportionment was somewhat arbitrary, in that it did not take the fair market value of the distributed assets into account, odd results could occur. One common situation involved the liquidation of a partnership with a relatively small amount of tangible assets (a pencil, for example) and a large amount of zero basis goodwill. Upon the purchase of a partnership interest followed by liquidation, former Code Sec. 732(c) apportioned the bulk of the purchase price to the pencil, which could then either be recovered through depreciation or sold for a taxable loss. Code Sec. 732(c), as amended by the Act, eliminates this result.

Berg notes, however, that even as amended, Code Sec. 732(c) does not apportion basis in accordance with relative fair market values. Rather, it uses a formulation somewhat similar to the regime for allocating basis adjustments under Code Sec. 755 following a Code Sec. 754 election. The practical result is that in a partnership that has both appreciated and depreciated assets, in cases where the distributee partner's basis in its partnership interest is equal to fair market value, the depreciated assets will not get stepped down and the appreciated assets will not be fully stepped up to fair market value.

Effective date. These provisions apply to distributions after August 5, 1997.

Act Sec. 1061(a), amending Code Sec. 732(c); Act Sec. 1061(b). Law at ¶ 5227. Committee Report at ¶ 11,415.

Precontribution Gain

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Background

Prior to amendment by the Act, Code Sec. 704(c)(1)(B) provided that if appreciated (or depreciated) property that had been contributed to the partnership was subsequently distributed by the partnership to another partner within five years of the contribution, the contributing partner was required to recognize the taxable precontribution gain (or loss). Similarly, Code Sec. 737 previously provided that the contributing partner must generally include any precontribution gain in income to the extent that the value of other property distributed by the partnership to the contributing partner, within five years after the contribution of the appreciated property, exceeded the contributing partner's adjusted basis in its partnership interest.

Recognition period extended to seven years.—The period in which a contributing partner will recognize precontribution gain from a distribution of contributed property is extended from five to seven years after the contribution. The seven-year recognition period applies to (1) a partnership distribution to a partner of appreciated property previously contributed by another partner (Code Sec. 704(c)(1)(B)) or (2) a partnership distribution to a contributing partner of other property, the value of which exceeds the contributing partner's basis in the partner's partnership interest (Code Sec. 737(b)(1)).

The House Committee Report anticipates that this extension of time will limit the inconsistency between the treatment of partnership sales and partnership distributions of property previously contributed by the partners. The House Committee Report also expects the legislation to reduce opportunities for partners to circumvent the rule requiring that any precontribution gain on contributed property be allocated to the contributing partner.

PRACTICAL ANALYSIS. Michael Cohen of Levun, Goodman & Cohen, Northbrook, Illinois, points out that the Taxpayer Relief Act of 1997 amends Code Sec. 704(c)(1)(B) and Code Sec. 737 to increase the "taint" on property contributed to a partnership from five years to seven years, effective for property contributions to a partnership occurring after June 8, 1997. In general, Code Sec. 704(c)(1)(B) provides that if a partner contributes property to a partnership and, within the proscribed period (now seven years), the contributed property is distributed to someone other than the contributing partner, the contributing partner will be responsible for recognizing the remaining Code Sec. 704(c) precontribution gain contained in the property. Concomitantly, Code Sec. 737 provides for gain recognition by the contributing partner where such partner receives a distribution of other partnership property within the proscribed seven-year period after having contributed the property to the partnership.

The effect of this legislative change is to make it more difficult to engage in what are commonly known as "mixing bowl" transactions. These transactions involve the contribution of appreciated property to a partnership by a person who desires to eventually divest himself of the property on a tax-free basis by receiving a nontaxable distribution of other partnership property. Now, the contributing partner will have to wait seven years before exiting the partnership to avoid the taint of Code Sec. 737.

Effective date. These provisions are generally effective for property contributed to a partnership after June 8, 1997. However, these amendments will not apply to any property contributed pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such contribution, if such contract provides for the contribution of a fixed amount of property.

Act Sec. 1063(a), amending Code Sec. 704(c)(1)(B) and Code Sec. 737(b)(1); Act Sec. 1063(b). Law at ¶ 5217 and 5230. Committee Report at ¶ 11,425.

PARTNERSHIP INTEREST SALES

Treatment of Inventory Items

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Background

Prior to amendment by the Act, Code Sec. 751(a) provided that upon the sale or exchange of a partnership interest, any amount received that was attributable to unrealized receivables, or to inventory that had "substantially appreciated," was treated as an amount realized from the sale or exchange of property that was

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not a capital asset (that is, the amount received was treated as ordinary income). The inventory of a partnership was treated as "substantially appreciated" only if the fair market value of the inventory exceeded 120 percent of the adjusted basis of the inventory to the partnership (see prior Code Sec. 751(d)(1)(A)).

With these two rules, Congress had attempted to provide a *de minimis* exception to the usual ordinary income treatment of all partnership inventory items so as to avoid subjecting every partnership to the complexities of Code Sec. 751, unless there was a material abuse of the capital gains rules. However, taking advantage of the opportunity, partners and their partnerships began to manipulate and plan around the substantial appreciation of partnership inventory requirement. Despite subsequent legislative efforts to reduce such manipulation and avoidance, such activities continued. Furthermore, it became apparent that this "safe harbor" requirement was ineffective at insulating a partnership from the potential complexity of the Code Sec. 751(b) disproportionate distribution rules. Complexity remained because the substantial appreciation requirement applied only to inventory items and not to unrealized receivables. The substantial appreciation requirement also operated to exclude ordinary income for partnerships with profit margins below 20 percent.

Inventory treatment conformed to treatment of unrealized receivables.—The substantial appreciation requirement for inventory is removed from the definition of Code Sec. 751 property for purposes of sales or exchanges of partnership interests. The amount received in exchange for the partner's interest that is attributable to unrealized receivables or inventory is treated as ordinary income. It is no longer necessary for the partnership's inventory to be substantially appreciated in order to give rise to ordinary income following a sale or exchange.

For disproportionate distributions of partnership property under Code Sec. 751(b), the substantial appreciation requirement remains intact. A disproportionate distribution to a partner will be treated as a sale or exchange of property other than a capital asset only if the inventory deemed to be exchanged is substantially appreciated in value.

PRACTICAL ANALYSIS. Chuck Levun of Levun, Goodman & Cohen, Northbrook, Illinois, observes that, under prior law, Code Sec. 751(a)(2) required that, upon the sale of a partnership interest, gain generated by the portion of the selling partner's partnership interest that was attributed to the partner's share of unrealized receivables or substantially appreciated inventory items (often referred to as "hot assets") would be treated as ordinary income, rather than capital gain.

Prior Code Sec. 751(d)(1)(A) required that, before inventory items, as broadly defined in Code Sec. 751(d)(2), would be treated as being substantially appreciated, the aggregate fair market value of all inventory items must exceed the partnership's aggregate tax basis in all such items by more than 20 percent. Amended Code Sec. 751(a)(2) removes the substantial appreciation requirement for treating inventory items as hot assets upon the *sale of a partnership interest.*

The effect of this provision is obviously to increase the probability that the sale of a partnership interest will produce some amount of ordinary income. It also produces a calculation preciseness that was not required before, due to the leeway that the 20-percent substantially appreciated requirement produced. One should also note that Reg. § 1.751-1(d)(2)(ii) treats *accrual basis* accounts receivable as inventory items. This had the effect of substantially reducing the aggregate percentage of appreciation in the partnership's inventory items (because the basis of the accounts receivable was almost always either equal to or greater than their fair market value). Although this regulation provision has not been changed, under the new "zero appreciation" rule of amended Code Sec. 751(d)(2), accrual basis accounts receivable will not eliminate the appreciated status of the other investment items.

Note that the prior law requirement that aggregate inventory items exceed their aggregate tax basis by more than 20 percent in order for inventory items to be considered hot assets has been retained with respect to gain or loss generated by a partnership *distribution* or deemed distribution of inventory items.

Effective date. These provisions are generally effective for sales, exchanges and distributions after August 5, 1997. However, these amendments do not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such sale or exchange.

Act Sec. 1062(a), amending Code Sec. 751(a)(2); Act Sec. 1062(b)(1)(A), amending Code Sec. 751(b)(1); Act Sec. 1062(b)(1)(B), adding Code Sec. 751(b)(3); Act Sec. 1062(b)(2), amending Code Sec. 751(d); Act Sec. 1062(b)(3), amending Code Sec. 724(d)(2), Code Sec. 731(a)(2)(B), Code Sec. 731(c)(6), Code Sec. 732(c)(1)(A) as amended by Act Sec. 1061(a), Code Sec. 735(a)(2) and Code Sec. 735(c)(1); Act Sec. 1062(c). Law at ¶ 5231. Committee Report at ¶ 11,420.

SIMPLIFIED FLOW-THROUGH: ELECTING LARGE PARTNERSHIPS

Simplified Reporting for Electing Large Partnerships

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Background

A partnership is treated as a conduit for federal tax purposes. Before enactment of the Taxpayer Simplification Act of 1997 (Act), and its addition of Code Secs. 771 through 777, every partnership, large or small, was required to separately report to each partner the partner's distributive share of every item of income, gain, loss, deduction, and credit. This regime resulted in the reporting of numerous items to each partner. Schedule K-1, on which separate partnership items are listed, contains space for more than 40 separate items. The reporting of such numerous separately stated items proved especially burdensome to individual investors who owned relatively small, passive interests in large partnerships. The great number of reportable items also made it difficult for the IRS to match those items reported on Schedule K-1 against the partner's income tax return, especially where the Schedule K-1 items were modified or limited at the partner level before

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appearing on the partner's return. Treatment of partnership items for partnerships other than those electing to apply the new simplified large partnership reporting provisions is described below.

Capital gains and losses. A partner's share of every partnership's net short-term capital gain or loss and net long-term capital gain or loss from portfolio investments is separately reported to the partner. Each partner's share of net gain or loss from the sale, exchange, or involuntary conversion of certain trade or business assets (see Code Sec. 1231) is usually separately reported as well. In general, the net gains from such assets are treated as long-term capital gains, but any net losses are treated as ordinary losses.

Deductions. A partner's share of miscellaneous itemized deductions and charitable contributions are separately reported to the partner. Miscellaneous itemized deductions are deductible by an individual partner only to the extent that, in the aggregate, they exceed two percent of the individual's adjusted gross income (AGI). Limitations on charitable contributions are applied at the partner level (under Code Sec. 170(b)(2)). Any excess contributions can be carried forward for five years.

Passive loss provisions. A partnership's operations may be treated as multiple activities for purposes of the passive loss rules. A partnership is required to separately report the items of income and deduction from each of its activities. Passive loss deductions and credits are generally disallowed to the extent that these exceed income from passive loss activities. Any losses that are not allowed in a tax year are suspended and treated as current deductions from passive activities in the next tax year. Losses are allowed in full when a taxpayer disposes of the taxpayer's entire interest in the passive activity to an unrelated person in a taxable transaction.

Portfolio income, such as interest and dividends, and expenses allocable to such income, is not treated as income or loss from a passive activity. Rental real estate activities in which the taxpayer materially participates are not subject to the passive loss limitations if the taxpayer meets certain eligibility requirements relating to real property trades or businesses in which the partner performs services (Code Sec. 469(c)(7)). A credit applicable to low-income housing and rehabilitation activities is available regardless of whether the taxpayer claiming the credit actively participates in the rental real estate activity generating the credit.

REMIC provisions. A tax is imposed on a partnership holding a residual interest in a real estate mortgage investment conduit (REMIC). The amount of the tax is the amount of excess inclusions allocable to partnership interests owned by certain tax-exempt organizations (disqualified organizations) multiplied by the highest corporate tax rate.

Optional basis adjustment election. In general, the transfer of a partnership interest or the distribution of partnership property does not affect the basis of partnership assets (the "inside" basis). A partnership may elect to make certain adjustments in the basis of partnership property (Code Sec. 754). Under a Code Sec. 754 election, the transfer of a partnership interest generally results in an adjustment in the partnership's basis in its property for the benefit of the transferee partner, to reflect the difference between that partner's basis for his interest and his proportionate share of the adjusted basis of partnership property (see Code Sec. 743(b)). Also, under this optional basis adjustment election, a

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distribution of property to a partner in certain cases results in an adjustment in the basis of other partnership property (see Code Sec. 734(b)).

Constructive termination of partnership. A partnership will technically terminate for tax purposes if, within a 12-month period, 50 percent or more of the total partnership interests are sold or exchanged (Code Sec. 708(b)(1)(B)).

Oil and gas activities. Partnerships engaged in the search for, and extraction of, crude oil and natural gas are subject to special tax rules, necessitating the separate reporting to partners of certain specific information. A taxpayer who owns an economic interest in a producing deposit of natural resources (including crude oil and natural gas) is permitted to claim a deduction for the depletion of the deposit as the minerals are extracted.

Cost or percentage depletion. For oil and gas produced in the United States, a taxpayer is generally permitted to claim the greater of a deduction for cost depletion or percentage depletion. Cost depletion is computed by multiplying a taxpayer's adjusted basis in the depletable property by a fraction, the numerator of which is the amount of current year production from the property and the denominator of which is the property's estimated reserves as of the beginning of that year. Percentage depletion is equal to a specified percentage of gross income from production. While cost depletion is limited to the taxpayer's basis in the depletable property, percentage depletion is not so limited. Once a taxpayer has exhausted its basis in the depletable property, it may continue to claim excess percentage depletion deductions.

Limitations on depletion deductions. The following limitations apply to the deduction for oil and gas percentage depletion:

(1) Percentage depletion is not available to oil and gas producers who also engage, directly or indirectly, in significant levels of oil and gas retailing or refining activities (so-called "integrated producers" of oil and gas).

(2) The deduction for percentage depletion may be claimed by a taxpayer only with respect to up to 1,000 barrels-per-day of production.

(3) The percentage depletion deduction may not exceed 100 percent of the taxpayer's net income for the tax year from the depletable oil and gas property.

(4) A percentage depletion deduction may not be claimed to the extent that it exceeds 65 percent of the taxpayer's pre-percentage depletion taxable income.

Depletion computed separately by partners. The depletion allowance is computed separately by the partners and not by the partnership. In computing a partner's basis in the partner's partnership interest, basis is increased by the partner's share of any partnership-related excess percentage depletion deductions and is decreased (but not below zero) by the partner's total amount of depletion deductions attributable to partnership property.

Intangible drilling and development costs. Intangible drilling and development costs (IDCs) incurred with respect to domestic oil and gas wells generally may be deducted at the election of the taxpayer. In the case of integrated producers, no more than 70 percent of IDCs incurred during a tax year may be deducted. IDCs not deducted are capitalized and generally are either added to the

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property's basis and recovered through depletion deductions or amortized on a straight-line basis over a 60-month period.

Qualifying large partnerships may elect simplified reporting system.— Large partnerships with 100 or more members may be eligible to significantly reduce the number of items that must be separately reported to their numerous partners. Simplification of reporting requirements for large partnerships is designed to ease the reporting burden faced by affected partners as well as to facilitate IRS computer-matching efforts. A qualified partnership must make an election in order for the large partnership reporting rules to apply. Service partnerships and commodity pools are generally ineligible to elect large partnership status. An electing large partnership has greater longevity than other partnerships and will not terminate for tax purposes solely because 50 percent or more of its interests are sold or exchanged within a 12-month period (under Code Sec. 708(b)(1)(B)).

An electing large partnership combines most items of partnership income, deduction, credit and loss at the partnership level and passes through net amounts to the partners. Special rules apply to partnerships engaging in oil and gas activities.

Electing large partnership. An "electing large partnership" is any nonservice partnership that elects to apply the simplified reporting provisions under Code Sec. 771 through Code Sec. 777, provided that the number of partners in the partnership equaled or exceeded 100 during the preceding tax year (Code Sec. 775(a)). A partnership may cease to be treated as an electing large partnership if the number of partners falls below 100 during any partnership tax year. Rules for determining the treatment of a partnership whose membership falls below 100 will be provided by regulations.

Caution. An election of large partnership status, once made, applies to the tax year for which it has been made and for all subsequent tax years, and is irrevocable without the consent of the IRS (Code Sec. 775(a)(2)). Careful consideration of the laws governing electing large partnerships should precede this permanent election.

Partnerships eligible to elect large partnership treatment. A partnership is generally eligible to elect large partnership status if it had 100 or more partners during the preceding tax year. However, certain service partnerships and commodity-trading partnerships are not eligible (see below).

Service partners not counted. Any individual partner who holds an interest in the partnership and who is presently performing substantial services in connection with the partnership's business activities, or who has performed such services in the past while a partner, is not counted toward achieving the 100-partner threshold (Code Sec. 775(b)(1)).

Indirect holders of partnership interests. The Conference Committee Report states that only those persons directly holding partnership interests in the applicable tax year, including persons holding through nominees, will be counted in determining the number of partners in the partnership. Persons holding their interests indirectly, such as through another partnership, will not be counted in this numerical determination, according to the Conference Committee Report. Indirect interests are not specifically addressed in the Code Sec. 775 definition of electing large partnerships.

Service partnerships not eligible for election. Certain service partnerships are not eligible to elect large partnership status. A partnership is an ineligible service partnership if substantially all of the partners fall within one of the following categories (Code Sec. 775(b)(2)):

(1) individuals performing substantial services in connection with the partnership's activities or who are personal service corporations (under Code Sec. 269A(b)), the owner-employees of which perform substantial services in connection with the partnership's activities;

(2) retired partners who had performed substantial services in connection with the partnership's activities; or

(3) spouses of partners who are performing or had previously performed such substantial services.

The partnership's activities include not only its own activities, but also the activities of any other partnership in which the partnership directly owns at least an 80-percent interest in the capital and profits (Code Sec. 775(b)(3)).

Commodity pools not eligible for election. An election to be treated as a large partnership will not be effective for any partnership whose principal activity is the buying and selling of commodities. Commodities that qualify as inventory, stock in trade or other property held for sale to customers in the ordinary course of business under Code Sec. 1221(1) are not counted for purposes of this exclusion. Options, futures or forwards relating to commodities count as sales of commodities (Code Sec. 775(c)).

Treatment on return binds partnership. If a partnership files a return for any year on which the partnership is treated as an electing large partnership, this treatment on the return will bind the partnership and all of its partners (Code Sec. 775(d)). The partnership will be bound whether or not it has affirmatively made an election to apply the large partnership reporting rules. The IRS, however, is not bound by the treatment on the return.

Change in interests will not terminate electing large partnership. Recognizing that large partnerships need to have readily transferable interests, an electing large partnership will not terminate for tax purposes solely because 50 percent or more of its interests are sold or exchanged within a 12-month period. Accordingly, the constructive termination rules of Code Sec. 708(b)(1)(B) do not apply to an electing large partnership (Code Sec. 774(c)).

Optional basis adjustments continue to apply. No changes to the optional basis adjustment provisions have been initiated as a result of the large partnership simplification rules. Accordingly, an electing large partnership may still elect to adjust the basis of partnership assets with respect to transferee partners. The computation of an electing large partnership's taxable income (under Code Sec. 773) is made without considering the Code Sec. 743(b) basis adjustment. As is the case for other, nonelecting partnerships, the Code Sec. 743(b) basis adjustment is made only with respect to the transferee partner. Additionally, an electing large partnership can continue to adjust the basis of partnership property under Code Sec. 734(b) if property is distributed to a partner (Code Sec. 774(a)).

Effective date. These provisions apply to partnership tax years beginning after December 31, 1997.

Act Sec. 1221(a), adding Code Secs. 771, 772, 773, 774, 775, 776, and 777; Act Sec. 1221(b); Act Sec. 1221(c). Law at ¶ 5233-5245. Committee Report at ¶ 12,215.

Partnership Computations and Pass-Throughs for Electing Large Partnerships

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Partnership computations and separately stated large partnership items.—The taxable income of an electing large partnership is generally computed in the same manner as that of an individual, with certain modifications. The deduction for personal exemptions under Code Sec. 151 and the net operating loss deduction under Code Sec. 172 are disallowed. Many additional itemized deductions are also disallowed, e.g., medical, alimony, and moving expenses. Miscellaneous itemized deductions are generally combined; instead of applying the two-percent floor to these items, 70 percent of these deductions are disallowed at the partnership level (Code Sec. 773(b)(3)). Limitations generally apply at the partnership level. Most elections affecting partnership income and credits are made by the partnership. Elections relating to foreign tax credits (Code Sec. 901) and elections relating to discharge of indebtedness income (Code Sec. 108) are made by the individual partners.

Items separately stated to each partner. In determining the taxable income of a partner of an electing large partnership, each partner in the large partnership takes into account separately the partner's distributive share of the following items, as determined at the partnership level (Code Sec. 772(a)):

(1) taxable income or loss from passive loss limitation activities;

(2) taxable income or loss from other activities (e.g., portfolio income or loss);

(3) net capital gain or loss allocable to passive loss limitation activities;

(4) net capital gain or loss allocable to other partnership activities;

(5) tax-exempt interest;

(6) applicable net alternative minimum tax adjustment separately computed for the passive loss limitation activities and the other activities;

(7) general credits;

(8) Code Sec. 42 low-income housing credit;

(9) Code Sec. 47 rehabilitation credit;

(10) foreign income taxes;

(11) Code Sec. 29 credit for producing fuel from a nonconventional source; and

(12) any other items to the extent that the IRS determines that separate treatment is appropriate.

Items that must be separately stated by most partnerships, but that escape separate reporting by an electing large partnership, include short-term capital gains and losses; gains from sales of Code Sec. 1231 property used in a trade or

business; charitable contributions; miscellaneous itemized nonbusiness deductions (most of which are not deductible by an electing large partnership); and separately enumerated alternative minimum tax preference items.

Character determined at partnership level. The character of any item separately stated to the partners is based on its character to the partnership. The items are treated as incurred by the partnership, similar to the character rule for other partnerships under Code Sec. 702(b) (Code Sec. 772(c)(1)). Net capital gain or loss is treated as long-term capital gain or loss (Code Sec. 772(c)(4)).

Passive loss limitation activities. A limited partner's distributive share of income or loss from passive loss limitation activities engaged in by the partnership will be treated as a single item from a single passive activity within the meaning of Code Sec. 469 (Code Sec. 772(c)(2)). Capital gain or loss from a passive activity (separately stated under Code Sec. 772(a)(3)(A)) is treated as derived from the conduct of a trade or business that is a single passive activity. Alternative minimum tax adjustments for passive loss limitation activities (separately stated under Code Sec. 772(a)(5)(A)) passed through to partners will also be treated as derived from a single passive activity. These rules apply only to limited partners. For general partners, items allocable to passive loss limitation activities must be separately stated as necessary to comply with Code Sec. 469 (Code Sec. 772(f)).

Income from discharge of indebtedness. Income from discharge of indebtedness is excluded from the partnership's portfolio income (reported under Code Sec. 772(a)) and must be taken into account separately by each partner (Code Sec. 773(c)). Rules governing discharge of indebtedness income (under Code Sec. 108) apply separately to each partner, as is the case for partners in other partnerships (under Code Sec. 108(d)(6)). The large partnership rules do not affect the treatment of the item at the partner level.

Unrelated business taxable income for tax exempts. A tax-exempt partner is subject to tax on its distributive share of partnership income to the extent that the partnership activity is an unrelated business with respect to the partner (Code Sec. 512). To accommodate this requirement, a tax-exempt partner's distributive share of partnership items must be taken into account separately under current law to the extent necessary for computing income from unrelated businesses (UBTI). This requirement is unchanged under the electing large partnership provisions (Code Sec. 772(e)).

Tax-exempt interest. Tax-exempt interest must be separately stated to each partner. Tax-exempt interest is interest on a state or local bond that is excludable from income under Code Sec. 103 (Code Sec. 772(d)(2)). Treatment of tax-exempt interest for the large partnership is the same as for other partnerships.

Limitations generally applied at the partnership level. Most limitations and other provisions affecting the computation of the taxable income or any credit of the electing large partnership are applied at the partnership level. For example, the limitation on miscellaneous itemized deductions applies at the partnership level; however, instead of the two-percent floor, 70 percent of the partnership's total miscellaneous itemized deductions are disallowed (Code Sec. 773(b)(3)). The deduction for charitable contributions is limited at the partnership level according to the percentage-of-income limitation usually applicable to corporations under Code Sec. 170(b)(2) (Code Sec. 773(b)(2)). The limitation is generally 10 percent of taxable income.

The following provisions will be applied at the partner level: Code Sec. 68 overall limitation on itemized deductions; Code Sec. 49 and Code Sec. 465 at-risk

limitations; Code Sec. 469 limitation on passive activity losses and credits; and any other provision specified in regulations (Code Sec. 773(a)(3)). The deduction for expenses for the production of income under Code Sec. 212, which might apply if the partner has a loss instead of "other" partnership income, is *not* treated as a miscellaneous itemized deduction at the partner level (Code Sec. 773(b)(2)). The deduction for Code Sec. 212 expenses is not subject to the two-percent floor under Code Sec. 67.

Elections affecting income and credits made at partnership level. Most elections affecting the computation of the taxable income of an electing large partnership, or affecting the computation of any credit claimed by a large partnership, must be made by the partnership. However, the Code Sec. 901 foreign tax credit election and any election relating to discharge of indebtedness under Code Sec. 108 must be made by each partner separately (Code Sec. 773(a)(2)). For example, the large partnership provisions do not affect Code Sec. 108(b)(5), providing for elections to reduce the basis of depreciable property, or the Code Sec. 108(c) election to exclude discharge of indebtedness income with respect to qualified real property business indebtedness (Code Sec. 773(c)).

Effective date. These provisions apply to partnership tax years beginning after December 31, 1997.

Act Sec. 1221(a), adding Code Sec. 772 and Code Sec. 773; Act Sec. 1221(c). Law at ¶ 5235 and 5237. Committee Report at ¶ 12,215.

Deductions and Credits for Electing Large Partnerships

¶ 414

Deductions and credits generally combined at partnership level.—An electing large partnership generally does not separately report deductions to partners. Expenses from passive activities are combined with income from passive activities in determining net income or loss. Miscellaneous itemized deductions are combined and reduced at the partnership level. The deduction for charitable contributions is determined at the partnership level and deducted in determining partnership income. Most credits are also combined into a single separately stated "general credit."

Miscellaneous itemized deductions disallowed at partnership level. Miscellaneous itemized deductions of an electing large partnership are not separately reported to the partners. In lieu of applying the two-percent floor for itemized deductions (under Code Sec. 67), 70-percent of the itemized deductions are disallowed at the partnership level (Code Sec. 773(b)(3)). The 70-percent cut is designed to approximate the amount of the deduction that would be lost to the individual partners under the two-percent floor. The remaining 30 percent is allowed at the partnership level in determining the large partnership's taxable income and is not subject to the two-percent floor at the partner level.

Charitable contributions not separately stated. An electing large partnership does not separately report its charitable contributions to the partners. Instead, the Code Sec. 170 charitable contribution deduction is allowed at the partnership level in determining the partnership's taxable income, subject to the 10-percent-of-taxable-income limitation applicable to corporate donors (Code Sec. 773(b)(2)).

General credits reported as single item. For the partners of electing large partnerships, all "general credits" are separately reported to the partners as a

single item. A partner's distributive share of general credits is taken into account as a current year general business credit (Code Sec. 772(c)(6)).

Credits included in general credit category. A "general credit" is defined as any credit other than the low-income housing credit, the rehabilitation credit, and the credit for producing fuel from a nonconventional source (Code Sec. 772(d)(5)). In recognition of their special treatment under the passive loss rules, the low-income housing and rehabilitation credits are separately reported, as is the credit for producing fuel from a nonconventional source.

The refundable credit for gasoline used for exempt purposes (under Code Sec. 34) and the refund or credit for undistributed capital gains of a regulated investment company (under Code Sec. 852(b)(3)(D)) are allowed to the electing large partnership, and thus are not separately taken into account by the partners of such partnership (Code Sec. 774(d)(1) and (2)).

Credit recapture applies at partnership level. Credit recapture is imposed at the partnership level for an electing large partnership (Code Sec. 774(b)(1)(A)). The amount of the recapture is determined by assuming that the credit that is subject to recapture had been fully utilized to reduce taxes (Code Sec. 774(b)(1)(B)). Credit recapture is first applied toward reducing the electing large partnership's current year credit, if any. If the recapture amount exceeds the amount of the current year's credit, the partnership is liable for the excess over that amount (Code Sec. 774(b)(2)). No credit recapture will be required as a result of any transfer of an interest in an electing large partnership (Code Sec. 774(b)(3)).

Foreign tax credit. The current foreign tax credit generally allows U.S. taxpayers to reduce U.S. income tax on foreign income by the amount of any foreign income taxes paid or accrued to foreign countries and to possessions of the United States with respect to that income (Code Sec. 901). Instead of claiming this foreign tax credit, a taxpayer may instead choose to deduct the foreign taxes. The total amount of the credit may not exceed the same proportion of the taxpayer's U.S. tax which the taxpayer's foreign source taxable income bears to the taxpayer's worldwide taxable income for the tax year.

Partners in an electing large partnership, like other taxpayers, may choose between the foreign tax credit and the foreign tax deduction (Code Sec. 772(d)(6)). Thus, the electing large partnership must continue to separately report to its partners creditable foreign taxes and the source of any income, gain, loss, or deduction taken into account by the partnership. All elections, computations, and limitations relating to foreign tax credits continue to be made by the partner as well.

Effective date. These provisions apply to partnership tax years beginning after December 31, 1997.

Act Sec. 1221(a), adding Code Secs. 772, 773 and 774; Act Sec. 1221(c). Law at ¶ 5235, 5237, and 5239. Committee Report at ¶ 12,215.

Gains and Losses of Electing Large Partnerships

¶ 415

Netting of capital gains and losses occurs at partnership level.—For electing large partnerships, netting of capital gains and losses occurs at the partnership level. Passive activity items are separated from capital gains stemming from partnership portfolio income. Each partner separately takes into ac-

count the partner's distributive shares of net capital gain or net capital loss for passive activity and portfolio items. Net capital gain or loss taken into account by a partner is treated as long-term capital gain or long-term capital loss (Code Sec. 772(c)(4)). Any excess net short-term capital gain over net long-term capital loss will be consolidated with the partnership's other taxable income and will not be separately reported.

Passive activity items are separately stated. A partner's distributive share of the partnership's net capital gain or loss is divided between passive loss limitation activities and other activities (Code Sec. 772(a)(3)). Capital gain is allocated to passive loss limitation activities to the extent that it derives from sales and exchanges of property used in connection with a passive activity. Any excess is allocated to "other" partnership activities (i.e., portfolio income) (Code Sec. 772(d)(4)(B)). A similar rule applies for purposes of allocating any net capital loss.

An activity is a passive loss limitation activity if it involves the conduct of a trade or business in which the taxpayer does not materially participate, or if it is a rental activity (Code Sec. 772(d)(1)). Generally, limited partners will not materially participate in any business conducted by the partnership. A trade or business is passive if it meets the definition in Code Sec. 469(c)(5) or (6).

Section 1231 gain. Any partnership gains and losses under Code Sec. 1231 will be netted at the partnership level. Net gain will be treated as long-term capital gain and is subject to the rules described above, and any net loss will be treated as ordinary loss and consolidated with the partnership's other taxable income.

Installment sale rules. Dispositions of residential time-shares and residential lots, generally treated as nondealer dispositions under the installment sale rules, are handled at the partnership level. If the electing large partnership wishes to report dispositions of these types of property under the installment method, the special interest charge imposed under Code Sec. 453(l)(2)(B) is calculated at the partnership level. The tax imposed, calculated under Code Sec. 453(l)(3), is computed using the highest individual or corporate tax rate in effect (Code Sec. 774(f)). Currently, the highest rate in effect is 39.6 percent. Interest on nondealer dispositions under Code Sec. 453A is also calculated at the partnership level, using the highest tax rate in effect under Code Sec. 1 or Code Sec. 11.

Effective date. These provisions apply to partnership tax years beginning after December 31, 1997.

Act Sec. 1221(a), adding Code Sec. 772 and Code Sec. 774; Act Sec. 1221(c). Law at ¶ 5235 and 5239. Committee Report at ¶ 12,215.

Passive Loss Provisions for Electing Large Partnerships

¶ 416

Passive loss limitation activities separately reported.—An electing large partnership must separately account for items attributable to passive loss limitation activities and "other" items (Code Sec. 772(a)). Since limited partners generally do not materially participate in the partnership's activities, most electing large partnership activities are passive loss limitation activities with respect to the limited partners. Portfolio income, such as interest or dividends, is categorized as income from "other" activities. Within these categories, income and loss from all sources is netted to arrive at a single item of net income or net loss.

Passive loss limitation activity. An activity is generally characterized as a passive loss limitation activity if it involves the conduct of a trade or business in which the taxpayer does not materially participate, or if it is a rental activity (Code Sec. 772(d)(1)). Generally, limited partners will not materially participate in any business conducted by the partnership. A trade or business is passive if its meets the definition set forth in Code Sec. 469(c)(5) or (6).

Items treated as derived from a single trade or business. Each partner must separately account for the partner's distributive share of income or loss from passive loss limitation activities. The partner's share of passive income or loss is generally treated as deriving from a single trade or business which is a passive activity under the Code Sec. 469 passive loss rules (Code Sec. 772(c)(2)). Limited partners are not required to separately report items from multiple passive activities.

Rules for general partners. A general partner in an electing large partnership must separately account for any items attributable to passive loss limitation activities to the extent necessary to comply with the Code Sec. 469 passive loss rules (Code Sec. 772(f)). Activities that are passive with respect to limited partners will not necessarily be passive with respect to a general partner who participates in the business. Thus, any income derived from an electing large partnership trade or business is not treated as passive income with respect to a general partner who materially participates in that activity.

Other activities. A partner's distributive share of income or loss from activities other than passive loss limitation activities is treated as income or expense attributable to property held for investment. Portfolio income (e.g., interest and dividends) is reduced by any portfolio deductions and allocable investment interest expenses at the partnership level and is separately reported to the partners as a single item. If the item is reported as a net expense relating to property held for investment, it is deductible by the partner under Code Sec. 212. However, the item will not be subject to the two-percent floor under Code Sec. 67 as is the case for most miscellaneous itemized deductions (Code Sec. 772(c)(3)).

Effective date. These provisions apply to partnership tax years beginning after December 31, 1997.

Act Sec. 1221(a), adding Code Secs. 771, 772, 773, 774, 775, 776, and 777. Law at ¶ 5233—5245. Committee Report at ¶ 12,215.

Alternative Minimum Tax Preferences for Electing Large Partnerships

¶ 417

Alternative minimum tax preferences determined at partnership level.—Alternative minimum tax (AMT) adjustments and preferences are combined at the partnership level. An electing large partnership reports to its partners a net AMT adjustment separately computed for passive loss limitation activities and other activities. In determining a partner's alternative minimum taxable income, the partner's distributive share of any applicable net AMT adjustment is taken into account instead of making separate AMT adjustments for different partnership items (as provided in Code Secs. 56, 57, and 58).

Net AMT adjustment. The net AMT adjustment is determined by using the adjustments applicable to individuals (in the case of partners other than corporations) and the adjustments applicable to corporations (in the case of corporate partners) (Code Sec. 772(d)(3)). Except as may be provided in regulations, the

applicable net AMT adjustment is treated as a deferral tax preference for purposes of the Code Sec. 53 minimum tax credit (Code Sec. 772(c)(5)).

Effective date. These provisions apply to partnership tax years beginning after December 31, 1997.

Act Sec. 1221(a), adding Code Sec. 772(d); Act Sec. 1221(c). Law at ¶ 5235. Committee Report at ¶ 12,215.

Electing Large Partnership with Residual Interests in REMIC

¶ 418

All partners treated as disqualified holders under REMIC rules.—All interests in an electing large partnership will be treated as held by disqualified organizations for purposes of the tax on partnerships holding residual interests in a real estate mortgage investment conduit (REMIC) (Code Sec. 774(e)(1)). An electing large partnership is thus discouraged from holding residual interests in a REMIC. An electing large partnership holding a residual interest in a REMIC is subject to an excise tax under Code Sec. 860E(e)(6). The amount of the tax is equal to the excess inclusions of the partnership (defined in Code Sec. 860E(c)) multiplied by the highest corporate tax rate (Code Sec. 860E(e)(6)(A)). The amount subject to tax is excluded from gross partnership income (Code Sec. 774(e)(2)).

No exception for entities furnishing affidavit. An electing large partnership may not avoid the tax imposed on transfers to a disqualified holder by furnishing an affidavit, as otherwise allowed under Code Sec. 860E(e)(6)(D) (Code Sec. 774(e)).

Effective date. These provisions apply to partnership tax years beginning after December 31, 1997.

Act Sec. 1221(a), adding Code Sec. 774(e); Act Sec. 1221(c). Law at ¶ 5239. Committee Report at ¶ 12,215.

Electing Large Partnership with Oil and Gas Activities

¶ 420

Reporting rules reflect limits on percentage depletion deductions.—Electing large partnerships with oil and gas activities ("oil and gas large partnerships") generally follow the same simplified reporting regime as other electing large partnerships. Depletion is generally computed at the partnership level. However, to prevent the extension of percentage depletion deductions to persons otherwise excluded, certain partners are treated as "disqualified persons," and special reporting rules apply.

Depletion generally computed at partnership level. The allowance for depletion claimed for any partnership oil or gas property under Code Sec. 611 must be computed at the partnership level. The provision under Code Sec. 613A(c)(7)(D), requiring depletion allowances to be computed separately by each partner, is disregarded for electing large partnerships. The limitation on depletion based on the amount of production, under Code Sec. 613A(c), is not used; depletion is also computed without regard to Code Sec. 613A(d)(1) (taxable income limitation) and Code Sec. 705(a)(3) (depletion basis adjustment) (Code Sec. 776(a)).

Computing the depletion deduction. An oil and gas large partnership computes its deduction for oil and gas depletion under the general statutory rules

(subject to certain exceptions) with the assumptions that (1) the partnership is the taxpayer and (2) it qualifies for the percentage depletion deduction. The amount of the depletion deduction, as well as other oil- and gas-related items, are generally reported to each partner (other than to partners who are disqualified persons) as components of that partner's distributive share of taxable income or loss from passive loss limitation activities. Neither the 1,000-barrel-per-day limitation on depletion deductions nor the 65-percent-of-taxable-income limitation on depletion deductions under Code Sec. 613A(d)(1) applies (Code Sec. 776(a)(2)).

Disqualified person's share of oil and gas items. A disqualified person's share of any item of income, gain, loss, deduction, or credit attributable to partnership oil or gas property is determined apart from the partnership's combined income under Code Sec. 773 and is not included in the items separately reported to the partner under Code Sec. 772 (Code Sec. 776(b)(1)). For example, in computing the partnership's net income from oil and gas for purposes of determining the intangible drilling costs (IDC) preference (if any) to be reported to partners who are not disqualified persons as part of the AMT adjustment, the disqualified persons' distributive shares of the partnership's net income from oil and gas are not taken into account.

An oil and gas large partnership reports information related to oil and gas activities to a disqualified partner in the same manner that the items were reported prior to the election, under the general rules of Subchapter K. The simplified reporting rules, however, do apply to the disqualified partner's share of items not related to oil and gas activities.

Disqualified persons. Two categories of taxpayers are defined as "disqualified persons." The first category includes certain retailers (Code Sec. 613A(d)(2)) and refiners (Code Sec. 613A(d)(4)), i.e., taxpayers who do not qualify for the Code Sec. 613A percentage depletion deduction. The second category includes any other person whose average daily production of oil and gas (for purposes of determining the depletable oil and natural gas quantity under Code Sec. 613A(c)(2)) exceeds 500 barrels for its tax year in which (or with which) the partnership's tax year ends (Code Sec. 776(b)(2)). In computing average daily production, all production of domestic crude oil and natural gas attributable to the partner is taken into account, including such partner's proportionate share of any production of the large partnership. Six thousand cubic feet of natural gas is treated as a "barrel" of crude oil (Code Sec. 776(b)(3)).

Disqualified person must notify partnership of its status. A taxpayer that falls within either disqualified person category, as described above, must notify any large partnership in which it holds a direct or indirect interest that it is a disqualified person. Thus, for example, if an integrated producer owns an interest in a partnership which, in turn, owns an interest in an oil and gas large partnership, the integrated producer must provide the management of the electing large partnership with information regarding its status as a disqualified person and the details regarding its indirect interest in the electing large partnership.

Intangible drilling and development costs (IDC). As under current law, the election to deduct IDCs under Code Sec. 263(c) is made at the partnership level. Since the new provisions treat those taxpayers required by Code Sec. 291 to capitalize 30 percent of IDCs as disqualified persons, an oil and gas large partnership may pass through a full deduction of IDCs to its partners who are not disqualified persons. In contrast to other partnerships, an oil and gas large partnership also has the responsibility with respect to its partners who are not disqualified persons for making a Code Sec. 59(e) election to capitalize and

amortize certain specified IDCs. Partners who are disqualified persons are permitted to make their own separate Code Sec. 59(e) elections.

Alternative minimum tax adjustment. Consistent with the general reporting regime for electing large partnerships, a single AMT adjustment is made and reported as a separate item to the partners (other than disqualified persons) of an oil and gas large partnership. This separately-reported item is affected by the limitation on the repeal of the tax preference for excess IDCs. The limitation on repeal of the IDC preference is applied at the partnership level and is based on the cumulative reduction in the partnership's alternative minimum taxable income resulting from repeal of that preference.

Effective date. These provisions apply to partnership tax years beginning after December 31, 1997.

Act Sec. 1221(a), adding Code Sec. 776; Act Sec. 1221(c). Law at ¶ 5243. Committee Report at ¶ 12,215.

SIMPLIFIED AUDIT PROCEDURES: ELECTING LARGE PARTNERSHIPS

New Audit Provisions

¶ 421

Background

All partnerships are generally subject to the unified audit rules under Code Sec. 6221 through Code Sec. 6233. These audit rules were established by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). The rules apply to all partnerships except for certain small partnerships with 10 or fewer partners.

Under TEFRA, the tax treatment of all partnership items is determined at the partnership, rather than at the partner, level. Prior to TEFRA, any adjustments to a partnership's items of income, gain, loss, deduction, or credit were made in separate proceedings with respect to each partner individually. Where a large partnership had partners located in different audit districts, such adjustments were made in numerous actions in multiple jurisdictions, occasionally with conflicting results.

Although TEFRA resolved many administrative and jurisdictional issues, unfortunately the audit procedures applicable to very large partnerships remained cumbersome, inefficient, and complex. The IRS often found itself assessing deficiencies arising from the audit of a large partnership against numerous partners, many of whom were difficult to locate and were no longer partners. This scenario was further complicated by the intervention of partners who had the right to act individually.

Treatment on partner's return. Every partner of every partnership is required to report all partnership items consistently with the partnership's return. In the alternative, a TEFRA partner can notify the IRS of any applicable inconsistency. Upon a partner's failure to report a partnership item consistently with that of the partnership, the IRS can make a computational adjustment and immediately assess any additional tax that results.

Separate assessments for partners. Although the IRS can challenge the reporting position of a partnership by conducting a single administrative proceeding to resolve an issue with respect to all of the partners, the IRS is still required, for a

Background

TEFRA partnership, to assess any resulting deficiency against each taxpayer who was a partner in the year in which the understatement of tax liability arose.

Separate refunds. Any TEFRA partner can request an administrative adjustment or a refund for the partner's own separate tax liability. Every partner also has the right to participate in partnership-level administrative proceedings and any settlement agreements with respect to partnership items that might arise.

Tax Matters Partner. The TEFRA rules establish the "Tax Matters Partner" as the primary representative of every partnership in dealings with the IRS. The Tax Matters Partner (TMP) is a general partner designated by the partnership or, in the absence of such a specific designation, the general partner with the largest profits interest at the close of the tax year. If no TMP is designated, and it is impractical to apply the largest profits interest rule, the IRS may then select any partner as the TMP.

Notice requirements. The IRS generally is required to give notice of the beginning of partnership-level administrative proceedings and any resulting administrative adjustment to all partners of every partnership whose names and addresses are furnished to the IRS. For partnerships with more than 100 partners, however, the IRS generally is not required to give notice to any partner whose profits interest was less than one percent.

Appeals of adjustments. After the IRS makes an administrative adjustment, the Tax Matters Partner and, in limited circumstances, certain other partners, can file a petition for readjustment of the partnership items in the Tax Court, the district court in which the partnership's principal place of business is located, or the Claims Court.

Electing large partnerships not subject to TEFRA audit procedures.— The Act creates a special audit system for qualifying large partnerships that have elected to apply the simplified flow-through reporting system under new Code Sec. 771 through Code Sec. 777 (Code Sec. 6240(a)). A partnership that elects the simplified pass-through system is an "electing large partnership." A partnership is generally eligible to elect to apply the new reporting rules if it had 100 or more partners during the preceding tax year, not counting service partners. A partnership is not eligible to elect simplified reporting if the principal business of the partnership is the buying and selling of commodities (including options, futures, and forwards), or if substantially all of the partners perform substantial services for the partnership (see the discussion of new Code Sec. 775, as added by Act Sec. 1221, at ¶ 412).

The partnership audit rules created by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), contained in Code Sec. 6221 through Code Sec. 6234, generally do not apply to an electing large partnership (Code Sec. 6240(a)).

Proceedings at partnership level. An electing large partnership, like other partnerships, appoints a representative to handle matters with the IRS. Unlike the TEFRA rules, the representative does not need to be a partner (Code Sec. 6255(b)). Only the partnership, and not the individual partners, will receive notice of partnership adjustments (Code Sec. 6245(b)). Only the partnership has the right to appeal the adjustment (Code Sec. 6247(a)).

Adjustments accounted for in year they take effect. The tax consequences of an adjustment to an electing large partnership item generally depend on the year

in which the adjustment "takes effect." For an adjustment resulting from an administrative request filed by the partnership (comparable to a refund claim), the adjustment takes effect when it is allowed by the IRS. An adjustment proposed by the IRS takes effect when it is made, unless the adjustment is appealed in court. An appealed adjustment takes effect when the decision of the court becomes final (Code Sec. 6242(d)(2)).

Adjustments passed through to current partners or treated as imputed underpayment. Once a partnership adjustment takes effect, an electing large partnership generally has two choices for handling the adjustment. The adjustment may be combined with similar partnership items for the current tax year and passed through to the current partners, who will treat the adjustment no differently from items arising in the current year. Alternatively, the partnership can elect not to pass the adjustment through to current partners, in which case the partnership will pay tax on any net adjustment at the highest individual or corporate rate, plus interest and penalties. The net adjustment paid for at the partnership level is an "imputed underpayment."

Prior-year partners and prior tax years not generally affected. Most adjustments to partnership items of an electing large partnership will not affect prior tax years of the partners, or tax years of former partners who left the partnership before the adjustment took effect. This simplification eliminates the need for the IRS to locate and assess taxes against large numbers of former partners. However, an adjustment that results in a change to a partner's distributive share (under Code Sec. 704) *will* require a change to the partner's tax year in which the item should have been reported (Code Sec. 6241(c)(2)(A)). Also, for a partnership that ceases to exist before an adjustment takes effect, the former partners will be required to take the adjustment into account in a manner to be prescribed by future regulations (Code Sec. 6255(d)).

Application of TEFRA audit rules. The usual TEFRA partnership-level audit rules (Code Sec. 6221 through Code Sec. 6234) will *not* apply to any electing large partnership, other than in its capacity as a partner in another partnership that is not also an electing large partnership (Code Sec. 6240(b)(1)). To the extent that an electing large partnership is a partner in another partnership that is not an electing large partnership, the usual TEFRA audit rules will apply to those items of the electing large partnership that are "partnership items" with respect to the nonelecting partnership. However, any adjustment made to the partnership items of the electing large partnership as a result of its interest in the nonelecting partnership will be taken into account in the same manner as other electing large partnership adjustments (Code Sec. 6240(b)). The term "partnership item" retains its existing Code Sec. 6231(a)(3) meaning (Code Sec. 6255(a)(2)).

Anticipated regulations. The IRS is specifically authorized to issue regulations as may be necessary to carry out the simplified audit procedures for electing large partnerships under Subchapter D. Among its directives, the IRS is empowered to prevent abuse of the new provisions through manipulation and to enforce the audit rules in circumstances that present special enforcement considerations (as defined in Code Sec. 6231(c)(1)) (Code Sec. 6255(g)). Circumstances that might present special enforcement considerations include termination or jeopardy assessments, cases involving indirect methods of proving income, and foreign partnerships.

Regulations are also specifically authorized for prescribing appropriate adjustments for purposes of taking into account partnership adjustments that involve a change in the character of any item of income, gain, loss, or deduction (Code Sec. 6242(d)(5)); and for taking into account partnership adjustments in cases where

the partnership has ceased to exist before the adjustment takes effect (Code Sec. 6255(d)).

The Conference Committee Report for the Taxpayer Relief Act of 1997 anticipates that future regulations may include rules addressing transfers of interests in electing large partnerships that are made in anticipation of partnership adjustments. Transfers to tax-favored persons are mentioned as a concern. Tax-favored persons include:

(1) corporations with net operating losses;

(2) tax-exempt organizations;

(3) foreign partners; or

(4) persons who are expected to be unable to pay the tax, such as shell corporations.

As an example, a transfer from a taxable partner to a nonresident alien to avoid tax on a subsequent adjustment might be addressed by regulations in one of the following ways:

(1) by providing that the income related to the partnership adjustment is effectively connected taxable income;

(2) by providing that the partnership adjustment is treated as taking effect before the partnership interest was transferred; or

(3) by treating the former partner as a current partner to whom the partnership adjustment is allocated.

PRACTICAL ANALYSIS. Andrew N. Berg of Debevoise & Plimpton, New York, N.Y., observes that the large partnership simplification provisions enacted in the 1997 Legislation represent a final success after several prior legislative attempts at large partnership simplification. Since the new legislation provides an elective regime, large partnerships will need to take a close look at the anticipated benefits and burdens in order to decide whether to elect in. A partnership considering the election should be certain it can comply with the requirement that it furnish return information to its partners by March 15.

As to simplification, tax reporting under the new regime will still be more complicated for individual partners when compared to investments that produce Form 1099-type reports. Ten enumerated types of income need to be separately stated plus an eleventh catch-all category is to be provided for in regulations.

The treatment of miscellaneous itemized deductions normally subject to Code Sec. 67 should be carefully considered by any partnership prior to making the election. New Code Sec. 773(b)(3) disallows 70 percent of those deductions at the partnership level, but permits 30 percent to be passed through to the partners. This is an economic benefit for partners who are individuals since it effectively allows them to deduct 30 percent of their itemized deductions. In the case of corporate partners, the provision is a detriment, disallowing 70 percent of certain deductions that otherwise would have been available.

> **Careful consideration will also need to be given to the provisions of the legislation dealing with partnership audit adjustments. Normally, a partnership audit adjustment requires a corresponding adjustment on the returns of the partners for the tax year which is subject to the adjustment. New Code Sec. 6242 provides that partnership adjustments will be taken into account in the year in which the adjustments take effect. For example, an item misreported in 1995, which is adjusted on audit in 1997, will affect 1997 tax liability. While this eliminates the horrific prospect of numerous partners having to amend prior-year returns, it will cause a shifting of the economic burden of the audit adjustment among partners in situations where there has been a change in partnership-sharing percentages over the years. A similar observation can be made with respect to Code Sec. 6242(a)(2), which permits partnerships to elect to pay any tax associated with an audit adjustment.**

Effective date. These provisions apply to partnership tax years ending on or after December 31, 1997.

Act Sec. 1222(a), adding Code Secs. 6240, 6241, 6242, 6245, 6246, 6247, 6248, 6251, 6252 and 6255; Act Sec. 1222(b)(1), amending Code Sec. 7421(a); Act Sec. 1222(b)(2), amending Code Sec. 7459(c); Act Sec. 1222(b)(3), amending Code Sec. 7482(b)(1)(E); Act Sec. 1222(b)(4), amending Code Sec. 7485(b); Act Sec. 1226. Law at ¶ 5641, 5643, 5645, 5647, 5649, 5651, 5653, 5655, 5657 and 5659. Committee Report at ¶ 12,245.

Partnership Adjustments

¶ 422

Electing large partnership adjustments generally pass through to current partners.—Adjustments to partnership items of an electing large partnership are generally passed through to current partners and treated as though they were items arising in the current tax year. Former partners and prior tax years of current partners are not generally affected by the adjustments. A change to a partner's distributive share, however, must be reflected in the partner's prior year return. An electing large partnership may elect not to pass through any or all partnership adjustments. A net adjustment that is not allowed to flow through to the partners will be treated as an "imputed underpayment." The partnership will owe tax on the imputed underpayment at the highest tax rate then in effect, in addition to interest and penalties.

Electing large partnership. The revised flow-through treatment for partnership adjustments applies only to qualified large partnerships that have elected to apply the simplified reporting rules under new Code Secs. 771 through 777. The term "electing large partnership" is defined under Code Sec. 775, as added by Act Sec. 1221 of the Taxpayer Relief Act of 1997 (P.L. 105-34).

Year in which partnership adjustment takes effect. The tax consequences of an adjustment to a partnership item of an electing large partnership depend on the year in which the adjustment "takes effect." For example, a partnership adjustment resulting in an increase in partnership income will be passed through as income to the partners for the year in which the adjustment takes effect.

For a partnership adjustment that has been appealed and is determined by a court decision, the adjustment takes effect when the court decision becomes final (Code Sec. 6242(d)(2)(A)). If the partnership adjustment arose due to an administrative adjustment request filed by the partnership (under Code Sec. 6251), the adjustment takes effect when it is allowed by the IRS (Code Sec. 6242(d)(2)(B)). In any other case, such as in cases where no appeal is filed following the notice of adjustment, the adjustment takes effect when it is made (Code Sec. 6242(d)(2)).

Caution. Foreknowledge of an impending large partnership adjustment might create a temptation to dispose of the partnership interest prior to the date that the partnership adjustment takes effect. The Conference Committee Report suggests that certain such pre-adjustment transfers to tax-favored persons who would be less susceptible to the tax effects of the adjustment might be viewed as abusive.

Adjustments flow through for year in which adjustment takes effect. Unlike the partnership-level audit rules under TEFRA (Subchapter C), an adjustment to any partnership item of an electing large partnership will generally flow through to the partners and be taken into account in determining the amount of the same item for the partnership tax year *in which the adjustment takes effect* (Code Sec. 6242(a)). If the partnership does not pass along the adjustment to the partners, or if the partnership specifically elects not to take the adjustment into account in determining partnership items for the year in which the adjustment takes effect, the partnership itself will owe tax on the adjustment.

The term "partnership adjustment" means any adjustment in the amount of any partnership item of an electing large partnership (Code Sec. 6242(d)(1)). The "adjusted year" is the partnership tax year to which the item being adjusted relates (Code Sec. 6242(d)(3)).

Adjusted items treated as arising in current year. An adjustment passed through to a partner in an electing large partnership is treated as an item actually arising during that tax year (Code Sec. 6242(a)(1)). Thus, the current-year partners' shares of current-year partnership items of income, losses, deductions, or credits will be adjusted to reflect those partnership adjustments from a prior year that take effect in the current year. Flow-through of electing large partnership items is determined under Code Sec. 772. Under the simplified reporting rules, not all adjusted items will be separately stated to each partner.

> **Example.** In 2002, Joe invests in an electing large partnership in the restaurant business, Dineco. For tax year 2002, Joe's one-percent distributive share of the partnership's taxable income from restaurant activities is $5,000. In addition, in 2002, the IRS disallows $5,000 of Dineco business expenses attributable to 1999 and makes a partnership adjustment in this amount. The adjustment will be applied in calculating the partnership's taxable income for 2002 and will result in an increase in Joe's distributive share of taxable income for 2002 (due to a reduction in business expenses treated as arising in 2002). Joe's share of the increase is $50 (one percent of the disallowed business expenses). Joe's total distributive share of partnership taxable income from restaurant activities is $5,050 for 2002.

Readjustment of adjustments. An electing large partnership adjustment is *not* treated as arising in the current year for purposes of determining partnership-level adjustments under Code Sec. 6245 through Code Sec. 6248. Also, under Code Sec. 6247(c), all items for the adjusted year may be readjusted by judicial review. An adjustment passed through to the partners (or taxed at the partnership level) will

not be subject to readjustment along with other items arising in the year that the adjustment takes effect (Code Sec. 6242(a)(4)).

Adjustment involving change in distributive shares. Electing large partnership adjustments generally do not affect the prior-year returns of any of the partners. However, an adjustment that involves a change to the partners' distributive shares under Code Sec. 704 is an exception to this rule and will not be treated as though the change arose in the year the adjustment takes effect. To the extent that any adjustment involves a change under Code Sec. 704 in a partner's distributive share of the amount of any partnership item, the adjustment must be taken into account by the affected partner for the partner's tax year in which the item was originally required to be taken into account (i.e., the prior tax year in which the faulty distributive share was applied) (Code Sec. 6241(c)(2)(A)).

The statute of limitations for assessing an underpayment attributable to a change in a partner's distributive share (or for filing a refund claim for an overpayment caused by a change in a partner's distributive share) is three years from the date the underlying partnership return was filed (or its due date not counting extensions, whichever was later) (Code Sec. 6241(c)(2)(C)). This is the same as the limitation period for making adjustments to the partnership return under Code Sec. 6248. However, the limitation period may be extended by agreement, or if their is fraud, etc.

The deficiency procedures provided for individuals (Subchapter B, Code Sec. 6211 through Code Sec. 6216), which require the IRS to issue a notice of deficiency and allow an individual to petition the Tax Court for redetermination of a deficiency, do not apply to an underpayment caused by a change in a partner's distributive share (Code Sec. 6241(c)(2)(B)(i)). These Subchapter B deficiency procedures also will not preclude the assessment or collection of an underpayment attributable to a change in distributive share. Conversely, the assessment or collection of this type of underpayment will not preclude any notice, proceeding, or other determination under the Subchapter B deficiency procedures (Code Sec. 6241(c)(2)(B)(ii)).

Change in distributive share for tiered structure. For a tiered-structure partnership, an adjustment attributable to a change in a partner's distributive share may pass through an additional level to the persons holding the interests in the middle tier, depending on whether the middle tier is also an electing large partnership. If the partner is an S corporation or a partnership other than an electing large partnership, the adjustment passes through to the shareholders and is taken into account for the tax year for which the partnership item was required to be taken into account (i.e., the adjusted tax year) (Code Sec. 6241(c)(2)(D)). If the partner is an electing large partnership, however, the adjustment will be treated in the same manner as other electing large partnership adjustments (under Code Sec. 6242). The adjustment will generally pass through to the partners in the middle-level electing large partnership for the year in which the adjustment takes effect, rather than the earlier tax year in which the item was required to be reported.

Electing large partnership that ceases to exist. If an electing large partnership ceases to exist before a partnership adjustment can take effect, the former partners of the partnership must take the adjustment into account in a manner to be provided by regulations (Code Sec. 6255(d)). Since electing large partnerships do not terminate under Code Sec. 708(b)(1)(B) as a result of a change in ownership (Code Sec. 774(c)), this provision will apply only to partnerships that have ceased business operations or that are no longer doing business in the form of an electing large partnership.

Effective date. These provisions apply to partnership tax years ending on or after December 31, 1997.

Act Sec. 1222(a), adding Code Secs. 6240, 6241, 6242 and 6255; Act Sec. 1226. Law at ¶ 5641, 5643, 5645 and 5659. Committee Report at ¶ 12,245.

Imputed Underpayment for Adjustments

¶ 423

Failure to pass along adjustments to partners will result in imputed underpayment for current partnership year.—Instead of passing an adjustment of any partnership item through to its partners, an electing large partnership may elect not to take an adjustment into account in determining the amount of any partnership item to be passed through. In such a case, or if (1) in filing its return for any partnership tax year, the partnership fails to fully take into account any partnership adjustment as required, or (2) any partnership adjustment involves a reduction in a credit that exceeds the amount of the credit as determined for the partnership tax year in which the adjustment takes effect, the partnership must pay an "imputed underpayment" (Code Sec. 6242(a)(2)).

The Conference Committee Report anticipates that an electing large partnership will be eligible to make an election to pay an imputed underpayment only if it meets requirements designed to ensure payment. The requirements will be outlined in future regulations. The Committee Report mentions foreign partnerships as a potential problem area.

Calculating imputed underpayment. An imputed underpayment resulting from an electing large partnership's failure to combine a partnership adjustment with similar partnership items arising in the year the adjustment takes effect is a liability of the partnership, and is not passed through to the partners. The imputed underpayment is calculated by netting all of the adjustments to the income and loss items of the large partnership. Any net increase in income is multiplied by the highest individual or corporate tax rate in effect for the adjusted year (currently 39.6 percent). A net decrease in a loss is treated as an increase in income, while an increase in a loss is treated as a decrease in income. Adjustments to credits are taken into account as increases (or decreases) in the amount of the tax (Code Sec. 6242(b)(4)).

Planning Note. An electing large partnership with many partners who are in lower tax brackets or are tax-exempt may lower the overall tax effect of adjustments by passing them through to partners rather than paying at the partnership level based on the highest available rate.

Offsetting adjustments. Whether or not a partnership adjustment actually flows through to the partners, an adjustment will be offset if it requires another adjustment in a tax year subsequent to the adjusted year but before the year that the original adjustment takes effect (Code Sec. 6242(a)(3)). For example, recharacterization of a deduction as a capital expense item requires adjustments to the depreciation claimed by the partnership in years following the adjusted year.

> **Example.** The SSB Partnership expensed a $1,000 item in year 1. In year 4, SSB determined that the item should have been capitalized and amortized ratably over a 10-year period. In this case, the adjustment in year 4 would be $700, apart from any interest or penalty, calculated as follows: the $900 adjustment for the improper deduction in year 1 would need to be offset by the $200 total of amortization deduction adjustments for years 2 and 3.

Thus, the year 4 partners would be required to include an additional $700 in income in year 4. SSB could then ratably amortize the remaining $700 of expenses in years 4-10.

Interest on imputed underpayments. The partnership, and not the partners individually, is liable for any interest and penalties that are imposed on an imputed underpayment (Code Sec. 6242(b)(1)). Interest on the imputed underpayment is determined under chapter 67—Code Sec. 6601 for the addition to tax and Code Sec. 6621 for the rate of interest (Code Sec. 6242(b)(2)).

The period for computing interest on an imputed underpayment begins on the return due date for the adjusted year and ends on the earlier of the return due date for the partnership tax year in which the adjustment takes effect or the date that the partnership pays the imputed underpayment (Code Sec. 6242(b)(2)(B)). Adjustments to the amount of interest determined under these rules will be made to account for any offsetting adjustments required for partnership tax years after the adjusted year and before the year in which the partnership adjustment takes effect (Code Sec. 6242(b)(2)). Thus, in the example above, SSB would be liable for four years' worth of interest on a declining principal amount.

For purposes of determining interest, both the imputed underpayment and the interest due on the underpayment are treated as an underpayment of tax (Code Sec. 6242(c)(2)).

Penalties on imputed underpayment. Any penalties that would apply to an individual will also apply to an electing large partnership owing an imputed underpayment. The imputed amount is treated as an actual underpayment (or understatement) for the adjusted year (Code Sec. 6242(b)(3)). Penalties, including accuracy-related penalties and fraud penalties, are determined on a year-by-year basis (without offsets) based on the imputed underpayment. The criteria for applying the penalties, including reasonable cause, substantial authority, etc., are the same criteria that would apply to an individual.

Special 10-percent penalty for late payments. In addition to paying the same penalties that are applicable to individuals, a special 10-percent penalty applies to an electing large partnership that fails to timely pay any imputed underpayment. The penalty is 10 percent of any remaining underpayment still owed by the tardy partnership as of the due date (Code Sec. 6242(c)(3)(A)).

Collection of imputed underpayment and interest. Required payments for imputed underpayments and interest must be paid on or before the due date for the partnership return for the year the adjustment takes effect. Any imputed underpayment or interest due on an underpayment will be assessed and collected in the same manner as an employment tax imposed under subtitle C (Code Sec. 6242(c)(1)).

Interest and penalties are nondeductible. No deduction is allowed for any payments made by an electing large partnership for an imputed underpayment or for interest and penalties on an imputed underpayment (Code Sec. 6242(e)).

Effective date. These provisions apply to partnership tax years ending on or after December 31, 1997.

Act Sec. 1222(a), adding Code Sec. 6242; Act Sec. 1226. Law at ¶ 5645. Committee Report at ¶ 12,245.

Partnership Adjustment Proceedings

¶ 424

Partners not involved in electing large partnership adjustment proceedings.—Similar to the audit proceedings for other partnerships under the TEFRA rules, the IRS may challenge a reporting position taken by an electing large partnership by conducting a single administrative proceeding, the outcome of which will bind all of the partners. Unlike partners in a TEFRA partnership, partners in an electing large partnership have no individual right to notice of the adjustment proceedings and no individual right to participate in the proceedings. The partnership can appoint any person to represent its interests for tax purposes, whether or not the person is a partner. After notice is sent to the partnership, the IRS must wait 90 days before making the adjustment, or until the outcome of any court proceeding brought as a result of the notice.

Partners are firmly bound by partnership treatment. A partner in an electing large partnership must report all partnership items consistently with their treatment on the partnership return. Unlike the comparable TEFRA audit rule under Code Sec. 6222, an inconsistency cannot be excused by notifying the IRS of the differing treatment (Code Sec. 6241(a)). Any underpayment of tax attributable to the partner's failure to comply with the consistency requirement is assessed and collected as if the underpayment were due to a mathematical or clerical error appearing on the partner's return (Code Sec. 6241(b)). The IRS can immediately assess any additional tax against the partner without issuing a notice of deficiency (see Code Sec. 6213(b)). The taxpayer has no right to petition the Tax Court for a redetermination of the deficiency. Also, no petition for abatement may be filed for any assessment of an underpayment caused by a partner's failure to consistently report an electing large partnership item (Code Sec. 6241(b)).

Partners who fail to report partnership items consistently with their treatment on the partnership return are subject to the accuracy-related and fraud penalties under Code Sec. 6662 and Code Sec. 6663 (Code Sec. 6241(d)).

Partnership representative not limited to general partner. Each electing large partnership is required to designate a partner or *other person* who will possess the sole authority to act on behalf of the partnership (similar to the tax matters partner under Code Sec. 6231(a)(7)). If the partnership does not designate a representative, the IRS may select *any* partner to act on the partnership's behalf (Code Sec. 6255(b)(1)). The range of eligible partnership representatives is significantly broadened from the TEFRA rules, which require a partnership to choose its representative from among the general partners.

IRS-appointed representatives. The IRS's ability to determine who properly represents an electing large partnership in cases where the electing large partnership fails to designate a representative is also significantly eased. For electing large partnerships, the IRS is empowered to designate any one of the partners as the person authorized to act on the partnership's behalf. The IRS need no longer bother with "largest profits interests" determinations, which can become a cumbersome task when the IRS is faced with a large partnership with numerous partners. For partnerships subject to the TEFRA rules, Code Sec. 6231(a)(7) requires the IRS to determine and appoint as tax matters partner the general partner with the largest profits interest in the partnership. After an IRS designation of a partnership representative, an electing large partnership can still designate another partner of its own choice to replace the IRS's appointee (Code Sec. 6255(b)).

Notice of proceedings to partners not required. The IRS is required to notify the electing large partnership of any partnership adjustment by sending certified or registered mail to the partnership's last known address (Code Sec. 6245(b)(2)). The IRS is not required to notify individual partners of the adjustment or the commencement of any administrative proceeding relating to the adjustment. Even if the partnership has terminated its existence, notice is proper if mailed to the last known address of the partnership.

Notice of adjustment may be rescinded. The IRS may rescind a notice of adjustment at any time without the consent of the partnership (Code Sec. 6245(b)(3)). A rescinded notice is not treated as a notice of partnership adjustment and may not be appealed. However, the statute of limitations on adjustments is still suspended during the time that the rescinded notice was outstanding.

Earliest date partnership adjustment may be made. The IRS must generally wait until the close of the 90th day after a notice of a partnership adjustment is mailed before making a partnership adjustment. This is also the earliest date that a levy or proceeding in any court may be made for the collection of an amount due as a result of an adjustment. If the partnership appeals the notice of adjustment by filing a petition with the Tax Court or other federal court, the earliest date that the adjustment may be made is the date that the decision of the court becomes final (Code Sec. 6246(a)). The principles for determining when a court decision becomes final are determined under Code Sec. 7481 (Code Sec. 6255(e)).

Premature action may be enjoined. An IRS action which is premature according to these rules may be enjoined in the proper court, including the Tax Court (notwithstanding the Code Sec. 7421 prohibition on suits to enjoin collection). To enjoin a premature action in the Tax Court, the electing large partnership must have filed a timely petition in the Tax Court requesting readjustment of the items listed in the notice. The Tax Court's jurisdiction is limited to the items that are the subject of the readjustment petition (Code Sec. 6246(b)).

Adjustment due to math or clerical error. An adjustment to an electing large partnership return made on account of a math or clerical error may be assessed and collected immediately, and the 90-day waiting period does not apply. Math error adjustments for electing large partnerships are governed by the same rules that apply to other taxpayers under Code Sec. 6213(b)(1) and Code Sec. 6213(b)(2). The IRS may summarily assess and collect the tax, and the taxpayer has no right to petition the Tax Court for a redetermination. However, the partnership representative may request an abatement of the tax within 60 days of receiving notification of the adjustment. Note that if the partnership is a partner in another electing large partnership, and its adjustment results from a failure to report an item consistently with its treatment on the source partnership's return, then the Code Sec. 6213(b)(2) abatement remedy is not available (see Code Sec. 6241(b)).

Waiver of restrictions on partnership adjustments. The partnership may waive any IRS restrictions on making large partnership adjustments by filing a signed written notice with the IRS. As with waivers for individuals, the partnership waiver will permit the IRS to immediately make its adjustment and will generally accelerate the adjustment proceedings.

Amount of final adjustment. If the partnership does not file a court petition for readjustment of the partnership items mentioned in the notice, then the partnership adjustment made by the IRS is limited to the amounts determined in the notice.

Effective date. These provisions apply to partnership tax years ending on or after December 31, 1997.

Act Sec. 1222(a), adding Code Secs. 6245 and 6246; Act Sec. 1226. Law at ¶ 5647 and 5649. Committee Report at ¶ 12,245.

Judicial Review of Adjustments

¶ 425

Partnership, but not partners, may petition for readjustment of partnership items.—An electing large partnership, like other partnerships subject to the TEFRA procedures, may request judicial review of a partnership adjustment (Code Sec. 6247(a)). Unlike TEFRA partners, the individual partners in an electing large partnership have no right to file petitions for readjustment of the partnership items.

Requirements for filing petition, in general. A readjustment petition may be filed by the partnership within 90 days of the date on which the notice of partnership adjustment is mailed to the partnership (Code Sec. 6247(a)). The petition may be filed with the Tax Court, the U.S. District Court for the district in which the partnership's principal place of business is located, or the Claims Court. The principal place of business for a partnership located outside the United States is the District of Columbia (Code Sec. 6255(c)).

Deposit required. An electing large partnership wishing to file a readjustment petition with a U.S. District Court or the Claims Court must make a payment deposit with the IRS on or before the date the petition is filed. The amount of the required deposit is the amount the partnership would owe as an imputed underpayment (under Code Sec. 6242(b)) assuming that the partnership items were adjusted as proposed in the IRS notice (Code Sec. 6247(b)(1)). The court may, by order, provide that the jurisdictional requirements are satisfied where there has been a good faith attempt to satisfy the deposit requirement, and any shortfall of the amount required to be deposited is timely corrected. A deposit made under this provision is not treated as a tax payment subject to interest requirements (Code Sec. 6247(b)).

Partnership items subject to review. A court with which a readjustment petition is filed has jurisdiction to determine the tax treatment of *all* partnership items for the tax year to which the notice of adjustment relates, and the proper allocation of adjusted items among the partners (Code Sec. 6247(c)). The court may also determine the applicability of any penalty, addition to tax, or additional amount for which the partnership may be liable under Code Sec. 6242(b). Thus, the court's jurisdiction is not limited to the items adjusted in the notice.

Dismissal of action treated as acceptance of partnership adjustment. If an action is dismissed other than by reason of an IRS decision to rescind the notice of adjustment, the court decision dismissing the action will be treated as a decision by the court that the notice of partnership adjustment is correct, and an appropriate order will be entered in the records of the court (Code Sec. 6247(e)).

Effective date. These provisions apply to partnership tax years ending on or after December 31, 1997.

Act Sec. 1222(a), adding Code Sec. 6247; Act Sec. 1226. Law at ¶ 5651. Committee Report at ¶ 12,245.

Period of Limitations

¶ 426

Three years from date of partnership return is general time limit on adjustments.—Absent an agreement to extend the statute of limitations, the IRS must generally adjust a partnership item of an electing large partnership within three years from the date that the partnership return was filed, or three years from the return's due date (not counting extensions), whichever is later (Code Sec. 6248(a)).

Extension by agreement. The limitation period for making a partnership adjustment may be extended by an agreement between the IRS and the partnership, entered into before the usual statute of limitations expires (Code Sec. 6248(b)).

Extension for fraud. As with returns filed by other taxpayers, there is no time limit on making adjustments to a false or fraudulent partnership return filed with intent to evade tax (Code Sec. 6248(c)(1)).

Extension for substantial omission of income. The three-year statute of limitations is extended to six years for adjustments made to any return on which the partnership fails to report as income an amount which is more than 25 percent of the gross income stated on the return (Code Sec. 6248(c)(2)).

Extension where partnership fails to file return. No time limit applies to adjustments made for any tax year in which the partnership fails to file a return (Code Sec. 6248(c)(3)). A return prepared by the IRS on behalf of the partnership is not treated as a return filed by the partnership (Code Sec. 6248(c)(4)).

Extension when notice of adjustment is mailed. The statute of limitations on making adjustments is suspended for the 90 days during which the partnership is allowed to file a court petition for readjustment of the partnership items listed in the IRS notice of adjustment (as provided under Code Sec. 6247). If the partnership does file a petition, the statute of limitations is also suspended for the period during which the court proceeding is pending. The limitations period will not end until one year after the date that the court decision becomes final (Code Sec. 6248(d)).

Extension during bankruptcy cases. In a Title 11 bankruptcy case, the statute of limitations on adjustments is suspended for the period during which the IRS is prohibited by reason of the bankruptcy case from making the adjustment and for 60 days thereafter. For a collection action suspended because of a bankruptcy stay, the period is suspended until six months after the stay is lifted (Code Sec. 6255(f)).

Effective date. These provisions apply to partnership tax years ending on or after December 31, 1997.

Act Sec. 1222(a), adding Code Sec. 6248; Act Sec. 1226. Law at ¶ 5653. Committee Report at ¶ 12,245.

Requests for Administrative Adjustment (RAA)

¶ 427

Electing large partnership, but not partners, may request adjustment.—An electing large partnership may file a request for an administrative adjustment (RAA) of any partnership item (comparable to a refund claim filed by

an individual). The request must generally be filed within three years of the date that the partnership return was filed, or three years from the return's due date, whichever is later. Individual partners do not have a right to file RAAs. A disallowed request may be appealed in the Tax Court, U.S. District Court, or Claims Court by filing a petition within two years of the date of the request.

Time limit for requesting administrative adjustment. An electing large partnership may file an RAA for any partnership tax year no later than (1) three years after the date on which the partnership return for the year was filed, or (2) three years after the due date for filing the partnership return (determined without regard to extensions), whichever is later (Code Sec. 6251(a)(1)). The RAA must be filed before the IRS mails a notice of adjustment with respect to that tax year (Code Sec. 6251(a)(2)).

Time limit where partnership has agreed to extend adjustment period. If the partnership has agreed to extend the allowable time for the IRS to make an adjustment under Code Sec. 6248, the time allowed for filing an RAA will be similarly extended. In this situation, the period for filing an RAA will not expire until six months after the expiration of the extended period for making adjustments (Code Sec. 6251(c)).

Appeal of disallowed adjustments. An electing large partnership may appeal any part of an RAA that is not allowed by the IRS. A petition for adjustment of the partnership item in dispute may be filed with the Tax Court, the U.S. District Court for the district in which the partnership's principal place of business is located, or the Claims Court (Code Sec. 6252(a)).

Date for filing appeal of disallowed adjustment. The earliest time that a partnership may file a court petition to obtain adjustment of partnership items is six months after the date that the RAA was filed. The latest date that the petition may be filed is two years after the date of the RAA. The two-year limit on petitions may be extended by a written agreement between the partnership and the IRS (Code Sec. 6252(b)).

Appeal disallowed if IRS mails notice of adjustment. No partnership petition relating to a disallowed adjustment can be filed after the IRS mails the partnership a notice of a partnership adjustment for the partnership tax year to which the RAA relates (Code Sec. 6252(c)(1)). If the IRS notice of adjustment is mailed *after* the petition is filed, but *before* a hearing on the petition is held, the petition will be treated as if it were a petition relating to the IRS notice, rather than a petition relating to the taxpayer's own RAA (Code Sec. 6252(c)(2)). No deposit of the estimated tax due will be required, however. An IRS notice is disregarded if mailed after the applicable period of limitations on adjustments has expired (Code Sec. 6252(c)(3)).

Scope of review limited to items in administrative request. A court in which a petition is filed will have jurisdiction to determine only those partnership items listed in the RAA and disallowed by the IRS, as well as partnership items to which the IRS asserts adjustments as offsets to the adjustments requested by the partnership (Code Sec. 6252(d)). However, if the action is transformed into a request for readjustment as a result of an intervening IRS notice of adjustment (as anticipated under Code Sec. 6252(c)(2)), then the scope of the review will not be limited by the content of the RAA. A court reviewing a petition treated as an appeal of a notice of adjustment will have jurisdiction over all partnership items for the tax year to which the notice of adjustment relates (Code Sec. 6247(c)).

Effective date. These provisions apply to partnership tax years ending on or after December 31, 1997.

Act Sec. 1222(a), adding Code Secs. 6251 and 6252; Act Sec. 1226. Law at ¶ 5655 and 5657. Committee Report at ¶ 12,245.

Due Date for Information Reporting

¶ 430

Background

Every partnership that is required to file Form 1065, U.S. Partnership Return of Income, with the IRS is obligated to furnish an information return (Schedule K-1, Partner's Share of Income, Credits, Deductions, etc.) to each of its partners on or before the due date of the partnership's tax return (including extensions). The partnership's return is due on or before the 15th day of the fourth month following the end of the partnership's tax year. For a calendar-year partnership, the return is due on or before April 15, which is the same date by which most individual partners must file their own tax returns. Receiving their Schedules K-1 on, or only shortly before, April 15 made it difficult for individual partners to use the partnership information to prepare their tax returns and to calculate any tax payments due on that date.

Information returns for partners of electing large partnership due March 15.—An electing large partnership must deliver Schedule K-1 information returns to its partners on or before the first March 15 following the close of the partnership's tax year. The specification of the due date contrasts with the general rule that requires a partnership to supply information returns to its partners no later than the due date of the partnership return. An electing large partnership is a partnership with 100 or more partners that has elected to be subject to the new simplified reporting and audit rules (see ¶ 412).

The earlier due date for Schedule K-1 information returns may reduce the number of partners who apply for extensions of time to file returns because they have not received their Schedules K-1 in time to complete their own returns.

Magnetic media. An electing large partnership is required to file its returns on magnetic media (see ¶ 469). Each partner's Schedule K-1 is treated as a separate information return for purposes of the corrective periods and penalties generally applicable to information returns.

Effective date. The provision is effective for partnership tax years ending on or after December 31, 1997.

Act Sec. 1223(a), amending Code Sec. 6031(b); Act Sec. 1223(b), adding new Code Sec. 6724(e); Act Sec. 1226. Law at ¶ 5581 and 5711. Committee Report at ¶ 12,275.

UNIFIED PARTNERSHIP PROCEEDINGS

Declaratory Judgment Procedure

¶ 431

Background

Under the rules enacted by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), partnership proceedings must be kept separate from deficiency proceedings involving the partners in their individual capacities. Prior to the Tax Court's opinion in *J. Munro,* 92 TC 71, Dec. 45,441 (1989), the IRS computed partner deficiencies by assuming that all of the items that were subject to the TEFRA partnership procedures were correctly reported on the partner's return. Consequently, if a partner claimed a loss from a TEFRA partnership that was so large that it offset any proposed adjustment to the partner's nonpartnership items, no deficiency could arise from the partner-level proceeding. If the claimed partnership losses were subsequently disallowed in the TEFRA partnership proceeding, the non-TEFRA adjustments to the partner's return might be uncollectible due to the expiration of the statute of limitations with respect to the nonpartnership items.

Faced with this situation when it examined Mr. Munro's tax return, the IRS issued a notice of deficiency to him that presumptively disallowed his partnership losses only for computational purposes at the partner level. The Tax Court, however, disapproved of this selective IRS methodology. Specifically, the court held that all partnership items (whether income, loss, deduction, or credit) included on a partner's return must be completely ignored in determining whether a deficiency exists that is attributable to nonpartnership items.

The *Munro* decision created problems for both taxpaying partners and the IRS. For example, a partner who invested in a TEFRA partnership and who was subject to deficiency procedures with respect to nonpartnership items would be harmed since computing his tax liability without regard to the partnership items would have the same effect as if all of the partnership items had been disallowed. If the ignored partnership items were losses, the partner would be faced with a greatly increased deficiency for the nonpartnership items. Even if, when the TEFRA partnership proceedings were completed, the partner was ultimately allowed any part of the partnership losses and he received part of the increased deficiency back in the form of an overpayment, in the interim, he would have been subject to assessment and collection of a deficiency inflated by items still in dispute in the partnership proceeding. In essence, such a partner would have been deprived of a prepayment forum with respect to the partnership item adjustments. Likewise, the IRS would be harmed when a partner's income is primarily from a TEFRA partnership. Since this income must be ignored for computational purposes at the partner level, the IRS would be unable to adjust nonpartnership items such as medical expense deductions, home mortgage interest deductions, or charitable contribution deductions because there would be no deficiency.

Declaratory judgment procedure for adjustments to oversheltered return.—The *Munro* decision, 92 TC 71, Dec. 45,441 (1989), has been legislatively overruled by the Act. As a result, the IRS is allowed to compute deficiencies by assuming that all TEFRA partnership items whose treatment has not yet been

finally determined have been correctly reported on the partner's return. This eliminates the need to do any special computations that involve the removal of TEFRA items from a partner's return. This has been accomplished by giving the IRS the right to use special procedures in the event of an "oversheltered return." The term "oversheltered return" means a tax return that:

(1) shows no taxable income for the tax year; and

(2) shows a net loss from TEFRA partnership items.

These special procedures come into play when a taxpayer files an oversheltered return for a particular tax year and:

(1) the IRS makes a determination with respect to the tax treatment of nonpartnership items on the return; and

(2) the adjustments that result from this determination do **not** give rise to a tax deficiency (as that term is defined in Code Sec. 6211), but would give rise to a deficiency if there had not been a net loss from the taxpayer's partnership items.

When these two conditions are met, the IRS is authorized to send a notice of adjustment reflecting its determination to the taxpayer by certified or registered mail. The procedures to be followed by the IRS are described in detail below.

Adjustment notice for oversheltered returns. When the taxpayer files an oversheltered return, the IRS is authorized to issue a notice of adjustment with respect to non-TEFRA items, even though no deficiency would result from the adjustment. However, the IRS can issue a notice of adjustment only if there would be a deficiency had there been no claimed net loss from partnership items. The notice of adjustment must be sent by certified or registered mail prior to the expiration of the Code Sec. 6501 limitations period for assessments.

The mailing of the notice suspends the running of the statute of limitations for assessments during the period that the IRS is barred from making an assessment plus 60 days. The IRS is barred from making an assessment during the 90-day (150-days if the notice is addressed to a person outside the U.S.) filing period and, if a Tax Court petition is filed, until the court's decision becomes final. If the IRS mails a notice of adjustment and the taxpayer files a timely Tax Court petition, the IRS cannot issue another notice to the taxpayer with respect to the same tax year absent a showing of fraud, malfeasance or misrepresentation of a material fact.

The notice of adjustment will be treated as a notice of deficiency if, after it is mailed, but before the filing period expires or a Tax Court determination is made, the TEFRA partnership items are finally determined or cease to be partnership items, thereby enabling the IRS to determine a deficiency. A Tax Court petition subsequently filed will be treated as a regular proceeding, rather than as a declaratory judgment proceeding.

The treatment of a partnership item is finally determined if:

(1) the IRS and the partner enter into a settlement agreement regarding the item;

(2) a notice of final partnership administrative adjustment (FPAA) has been issued and the time for filing a petition for judicial review has expired without a petition being filed, or a final court decision has been entered on a filed petition; or

(3) the period of tax assessment attributable to the item has expired.

If the IRS mails a notice of adjustment to a taxpayer and it is later determined that a notice of deficiency, rather than a notice of adjustment, should have been mailed, the notice of adjustment is treated as a notice of deficiency. A petition filed in response to the notice is treated as an action brought under Code Sec. 6213 (i.e., rules pertaining to deficiencies). Conversely, if the IRS mails a notice of deficiency, rather than a notice of adjustment, the notice of deficiency is treated as a notice of adjustment. A petition filed in response to the notice is treated as a petition for redetermination of adjustments.

Declaratory judgment proceeding. The taxpayer has 90 days after the day the notice is mailed to file a Tax Court petition challenging the correctness of the adjustments. The filing period is extended to 150 days after the day of mailing if the notice is addressed to a person outside of the United States. If the taxpayer files a petition, the Tax Court has jurisdiction to determine the correctness of the adjustment. The Tax Court also has authority to make a declaration with respect to all other items for the tax year at issue, except partnership items and affected items requiring a partner-level determination.

If the Tax Court subsequently determines that the IRS's adjustments are correct, the taxable income deemed to have been reported on the partner's return is increased. If the partner's TEFRA partnership items are then adjusted in a subsequent proceeding, the IRS has preserved its ability to collect tax on any increased deficiency attributable to the nonpartnership items.

Although no tax is immediately due upon the Tax Court's determination, its declaration has the same force and effect as a final Tax Court decision and is reviewable as such should either the partner or the IRS wish to appeal the court's decision.

Failure to file petition. If the taxpayer does not file a timely Tax Court petition, the IRS's determination set forth in the notice of adjustment is deemed be correct. However, the two following exceptions exist. The notice is not deemed correct if the taxpayer files a timely Tax Court petition with respect to a subsequent notice issued for the same tax year. Also, the notice is not deemed to be correct if the taxpayer files a refund claim for an overpayment of tax for the tax year involved.

Refund claim after defaulted notice. The new law provides that when the partner's TEFRA partnership items are finally determined, the partner is entitled to file a refund claim for any tax attributable to the items adjusted by an earlier notice of adjustment for the tax year, even though the taxpayer defaulted on the notice of adjustment. Although such a refund claim is not generally permitted with respect to a deficiency arising from a TEFRA proceeding, Congress believes that such a right is appropriate with respect to the defaulted notice of adjustment because the partner could not challenge the notice when issued, because it does not require the payment of an additional tax.

If a refund claim is filed, then while the claim is pending (and until the decision in any subsequent refund suit becomes final), items that are the subject of the notice of adjustment are presumed to have been correctly reported on the taxpayer's return. This presumption of correctness applies solely for purposes of determining the amount of any computational adjustment in connection with a TEFRA partnership proceeding or the amount of any deficiency attributable to affected items in a Code Sec. 6230(a)(2) proceeding.

Coordination with other proceedings. If the treatment of an item has been determined either by a declaratory judgment proceeding or by the partner's

default on the notice of adjustment, that treatment is taken into account in any computational adjustment made in connection with a partnership proceeding under the TEFRA audit rules or in a nonpartnership deficiency proceeding. These adjustments are taken into account without regard to whether an assessment has been made with respect to the adjustments.

When a computational adjustment is made in a TEFRA partnership proceeding, the items determined in the proceeding are not included unless the computational adjustment is made within the limitations period for assessment under the TEFRA audit rules. Thus, the Act clarifies that deficiency procedures do not apply with respect to this increase in tax liability, and the statute of limitations applicable to TEFRA proceedings control.

Treatment as notice of deficiency. A notice of adjustment is treated as a notice of deficiency if, after the mailing of the notice but before either the filing period elapses or a Tax Court declaration is made, a deficiency can be determined regarding a partnership item either because the treatment of a partnership item is finally determined or the item ceases to be a partnership item. Any petition filed after this is treated as a petition brought on the deficiency notice.

Effective date. These provisions are effective for partnership tax years ending after August 5, 1997.

Act Sec. 1231(a), adding new Code Sec. 6234; Act Sec. 1231(b), adding new Code Sec. 6211(c); Act Sec. 1231(c), conforming table of sections for subchapter C of Chapter 63; Act Sec. 1231(d). Law at ¶ 5619 and 5639. Committee Report at ¶ 12,315.

Application of TEFRA Based on Partnership Return

¶ 435

Background

Although the Tax Equity and Fiscal Responsibility Act of 1982 established unified audit rules applicable to most partnerships, it provided an exception for certain small partnerships with individual partners who each shared all of the partnership's items of income, loss, credit, and deduction according to a set allocation. Consequently, partners in partnerships with 10 or fewer partners, each of whom is a natural person (other than a nonresident alien) or an estate, and for which each partner's share of each partnership item is the same as that partner's share of every other partnership item, are subject to the regular deficiency procedures.

The IRS often found it difficult to readily determine whether to follow the TEFRA partnership procedures or the regular deficiency procedures in regard to the smaller partnerships. This difficulty arose primarily from the IRS's inability to discern whether all of the requirements for the special treatment had been met. For example, if the IRS determined that there were fewer than 10 partners in a partnership but was unaware that one of the partners was a nonresident alien, the IRS might inadvertently apply the wrong procedures and possibly jeopardize any assessment.

Partnership return determinative of audit procedures to be followed.— A partnership's tax return will determine whether the TEFRA audit procedures are followed. New Code Sec. 6231(g) enables the IRS to apply the TEFRA audit procedures when the IRS reasonably determines, based on the partnership's return

for the year at issue, that those procedures should apply. Conversely, if the IRS reasonably determines from the return that the TEFRA rules do not apply, then those rules are not applied. The IRS's initial determination will stand, even if it subsequently proves to be erroneous.

> **Example.** TraPark, a 250-member partnership, consolidates items on its return and follows the simplified flow-through rules established for electing large partnerships. However, no election statement is filed with the IRS. Based upon an examination of the return, the IRS reasonably determines that the audit procedures for electing large partnerships under new subchapter D, rather than the TEFRA procedures under subchapter C, apply.

Effective date. The provision is effective for partnership tax years ending after August 5, 1997.

Act Sec. 1232(a), adding new Code Sec. 6231(g); Act Sec. 1232(b). Law at ¶ 5637. Committee Report at ¶ 12,320.

Statute of Limitations

¶ 437

Background

Prior to the enactment of the Taxpayer Relief Act of 1997, the manner in which the statute of limitations could be tolled was different for regular deficiency cases and for TEFRA partnership cases.

Under the regular deficiency procedures, the filing of a Tax Court petition tolls the running of the statute of limitations for assessment, whether the petition is timely or not. The limitations period for the assessment and collection of tax is suspended until 60 days after the entry of a final Tax Court decision. However, Code Sec. 6229(d), the counterpart to Code Sec. 6503(a) in TEFRA cases, provided that the period of limitations was suspended for the time during which an action could be brought under Code Sec. 6226 and, if an action was actually brought during this period, until one year after entry of a final court decision on the matter.

Consequently, the tolling of the statute of limitations in a TEFRA case only occurred upon the filing of a *timely* petition. If an untimely petition was filed in a TEFRA case, the statute of limitations could actually expire while the case was still pending. To avoid such result, the IRS was often compelled to make burdensome assessments against all of the partners during the pendency of the action and subsequently to abate such assessments if the Tax Court later determined that the petition was in fact timely.

Untimely TEFRA petition suspends limitation period.—The statute of limitations in TEFRA cases is tolled by the filing of *any* petition under Code Sec. 6226, regardless of whether the petition is timely or valid. Accordingly, if the statute of limitations period is open when an untimely TEFRA petition is filed, the limitations period will not continue to run, and possibly expire, while the action is pending before the Tax Court. This modification conforms the rule governing the suspension of the statute of limitations for the filing of TEFRA petitions to the rule applicable to deficiency cases. As is the case under current law, the suspension continues until the decision of the court becomes final and for one year thereafter.

Effective date. The provision applies to partnership tax years with respect to which the period under Code Sec. 6229 for assessing tax has not expired on or before August 5, 1997.

Act Sec. 1233(a), amending Code Sec. 6229(d)(1); Act Sec. 1233(d)(1). Law at ¶ 5633. Committee Report at ¶ 12,325.

¶ 438

Background

The limitations period for assessing tax on partnership items generally is the longer of the Code Sec. 6229 limitations period or the Code Sec. 6501 limitations period. For partnership items converted to nonpartnership items, the limitations period cannot expire until one year after the items become nonpartnership items. The Code Sec. 6501 limitations period is expressly suspended during a bankruptcy proceeding. However, there was no statutory provision suspending the running of the Code Sec. 6229 limitations period during the taxpayer's bankruptcy proceeding. This ambiguity made it difficult for the IRS to adjust partnership items converted to nonpartnership items for a taxpayer who was a debtor in a bankruptcy proceeding. If the limitations period was not tolled, it could continue to run during the pendency of the bankruptcy proceeding even though the automatic stay provisions of the Bankruptcy Code prohibited the IRS from making an assessment.

Bankruptcy proceedings against partner toll limitations period.—The running of the one-year limitations period for partnership items converted to nonpartnership items is suspended for a partner named as a debtor in a Title 11 bankruptcy petition. This modification is designed to resolve the current uncertainty regarding whether bankruptcy tolls the limitation period for converted partnership items in the same way in which it is tolled for nonpartnership items.

Caution. However, the Conference Committee Report expressly states that the provision is not intended to create any inference regarding the interpretation of prior law.

The suspension of this one-year limitations period continues for the entire time during which the IRS is prohibited by reason of the bankruptcy proceeding from making an assessment and for 60 days thereafter.

Effective date. The provision applies to partnership tax years for which the Code Sec. 6229 limitations period has not expired on or before August 5, 1997.

Act Sec. 1233(b), adding new Code Sec. 6229(h); Act Sec. 1233(d)(1). Law at ¶ 5633. Committee Report at ¶ 12,330.

¶ 439

Background

The statute of limitations can be extended with respect to all of the partners if there is a written agreement between the partnership's tax matters partner (TMP) and the IRS. Temporary regulations provide that a TMP's status as tax matters partner terminates upon the filing of a bankruptcy petition in which the TMP is named as a debtor. Accordingly, if a person who would be a partnership's TMP but for the fact that he or she was a debtor in bankruptcy subsequently signs an agreement extending the partnership's statute of limitations period, this consent is not binding upon the other partners because the signatory was no longer the TMP when the agreement is executed.

Background

Because the IRS, for any number of administrative and jurisdictional reasons, cannot always be aware whether the TMP of an audited partnership is in bankruptcy or not, it often found itself in a position of detrimental reliance. Prior to the enactment of a new clarifying provision, if the IRS did not discover that a person signing a consent, who it believed to be the TMP, was in bankruptcy, the IRS could mistakenly rely on that consent and subsequently be precluded from assessing any tax attributable to partnership item adjustments with respect to any of the partners in the partnership.

Bankrupt TMP's limitations waiver binds other partners.—The IRS can rely on an extension of a partnership's limitations period signed by the person who would be the tax matters partner (TMP) but for the fact that that person was a debtor in a Title 11 bankruptcy proceeding when the extension was executed. However, the IRS can rely on the extension only if it has not been properly notified (as prescribed by regulations) of the bankruptcy proceedings. If the IRS was not properly notified of the bankruptcy, then any extension of the limitations period signed by the ostensible TMP is binding on all of the partners in the partnership. The provision applies notwithstanding any other rule of law.

Caution. The Conference Committee Report expressly states that the provision is not intended to create any inference regarding the proper interpretation of prior law.

Effective date. The provision applies to extension agreements entered into after August 5, 1997.

Act Sec. 1233(c), redesignating Code Sec. 6229(b)(2) as Code Sec. 6229(b)(3) and adding new Code Sec. 6229(b)(2); Act Sec. 1233(d)(2). Law at ¶ 5633. Committee Report at ¶ 12,335.

¶ 443

Background

The limitations period for assessing tax on partnership items generally is the longer of the Code Sec. 6229 limitations period or the Code Sec. 6501 limitations period. For partnership items converted to nonpartnership items, the limitations period cannot expire until one year after the items become nonpartnership items. A partner's partnership items become nonpartnership items for a given tax year when the partner and the IRS enter into a settlement agreement covering those items. Thus, the one-year extension of the limitations period begins to run when the partial settlement agreement is entered into.

When a partial settlement agreement is entered into, the one-year assessment period for the items covered by the agreement will likely be different from the Code Sec. 6501 assessment period for the remaining items. Prior to the recent amendment, the differing limitations periods posed significant tracking problems for the IRS and necessitated multiple tax computations relative to each partner's investment in the partnership for the tax year.

Partial settlements excluded from limitations period.—When a partner and the IRS enter into a settlement agreement regarding only some of the partnership items in dispute for a particular partnership tax year, the limitations period for assessing tax attributable to the settled items is determined as if the

agreement had not been entered into. Thus, the one-year extension of the limitations period that applies when an item is converted to a nonpartnership item does **not** begin to run when a partial settlement is executed. As a result, the one-year period begins to run when the last item is resolved. This period is controlling for all of the disputed partnership items for the partnership tax year.

> **Example.** Fred Martin entered into a settlement agreement on August 12, 1997 in which the treatment of one partnership item was settled. Three additional partnership items remained at issue. On October 24, 1997, the remaining items were resolved and a settlement agreement covering those items was executed. Because the first settlement did not cover all items, it had no effect on the limitations period. All of the items were resolved with the second agreement and, as a result, that is when the one-year period begins to run with respect to all of the items (on October 24, 1997).

Caution. The Conference Committee Report expressly states that this provision is not intended to create any inference regarding the proper interpretation of prior law.

Effective date. This provision is effective for settlements entered into after August 5, 1997.

Act Sec. 1235(a), amending Code Sec. 6229(f); Act Sec. 1235(b). Law at ¶ 5633. Committee Report at ¶ 12,350.

Small Partnership Exception

¶ 445

Background

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) established unified audit rules applicable to all partnerships, except for certain partnerships characterized as small partnerships. Prior to amendment by the Taxpayer Relief Act of 1997, a small partnership was defined as a partnership with 10 or fewer partners, each of whom was a natural person (other than a nonresident alien) or an estate. In addition, each partner's share of each partnership item had to be the same as that partner's share of every other partnership item (the so-called "same share" rule).

The partners in these exempted small partnerships remained subject to the regular deficiency procedures, rather than the unified audit procedures. Before the expansion of the definition of a small partnership for purposes of the special exemption, having a C corporation as a partner or making a special allocation automatically subjected the partnership to the TEFRA audit procedures.

Small partnerships can include C corporations as partners and make special allocations.—A small partnership can now include C corporations as partners without losing its exemption from the TEFRA audit procedures. Prior to this modification, a small partnership could have only individuals (other than nonresident aliens) or deceased partner's estates as partners. As under current law, a small partnership, for purposes of the TEFRA exemption, must have 10 or fewer partners. In determining whether the requirements are met, a husband and wife (and their estates) are treated as one partner.

Planning Note. A flow-through entity, such as an S corporation or a partnership, remains ineligible as a partner for purposes of qualifying for the "small partnership" exception.

Special allocations permitted. The "same share" rule, that is, the requirement that each partner's share of a partnership item must be the same as that partner's share of every other partnership item, has been removed. Thus, a partnership may specially allocate partnership items of income, loss, deduction and credit without jeopardizing its exemption from the TEFRA partnership rules.

Effective date. The provision is effective for partnership tax years ending after August 5, 1997.

Act Sec. 1234(a), amending Code Sec. 6231(a)(1)(B)(i); Act Sec. 1234(b). Law at ¶ 5637. Committee Report at ¶ 12,345.

Extensions to Request Administrative Adjustment

¶ 447

Background

If the partners of a non-TEFRA partnership agree to extend the applicable statute of limitations for tax assessments, that agreement also extends the statute of limitations for filing a subsequent refund claim. However, there was no comparable provision for extending the time for filing a refund claim with respect to partnership items subject to the TEFRA partnership rules. Prior to enactment of a new statute, this absence of an extension for the filing of a refund claim in a TEFRA proceeding hindered partners that wanted to agree to extend the TEFRA statute of limitations but who also wanted to preserve their option to file a refund claim.

Extension of TEFRA limitations period extends limitations period for refund claims.—If a partnership and the IRS agree to extend the TEFRA limitations period for tax assessments, that agreement also serves to extend the limitations period for filing a refund claim attributable to the disputed partnership items or affected items. A partner in a TEFRA partnership now has six months after the expiration of the limitations period for assessments in which to file a refund claim.

Effective date. The provision applies to partnership tax years beginning after September 3, 1982, and applies to any partnership tax year ending after this date if the partnership, each partner, and each indirect partner requests such application and the IRS consents to such application.

Act Sec. 1236(a), redesignating Code Sec. 6227(b) and Code Sec. 6227(c) as Code Sec. 6227(c) and Code Sec. 6227(d), respectively, and adding new Code Sec. 6227(b); Act Sec. 1236(b). Law at ¶ 5631. Committee Report at ¶ 12,355.

¶ 449

Background

Generally, a partner in a non-TEFRA partnership may file a claim for a credit or refund until the later of (1) three years from the date that the return was filed or (2) two years from the date that the claimed tax was paid. However, if the

Background

overpayment results from a deduction for a worthless security or a bad debt, the partner has seven years from the due date of the return to file a refund claim.

Partners in a TEFRA partnership may file a request for administrative adjustment (RAA) within three years after the later of (1) the date that the partnership return was actually filed or (2) the due date of the partnership return (determined without regard to extensions). Unlike non-TEFRA partners, they do not have the benefit of a filing extension for claiming overpayments arising from a worthless security or a bad debt.

Time for filing RAA on bad debts or worthless securities extended to seven years.—The Act extends the time by which partners in TEFRA partnerships must file a request for administrative adjustment (RAA) relating to the partnership's deduction of a bad debt or worthless security. The filing deadline is now seven years from the due date (without regard to extensions) of the partnership return with respect to which the RRA is made. Generally, this constitutes a four-year extension of the filing deadline. Despite this significant extension, the RAA must still be filed before any final partnership administrative adjustment (FPAA) is mailed for the tax year.

Planning Note. In effect, the extension gives a TEFRA partner filing an RAA a statute of limitations similar to that of a non-TEFRA partner filing a similar claim for refund.

Effective date. The provision is generally applicable to partnership tax years beginning after September 3, 1982. However, special rules apply to RAAs filed before August 5, 1997. In the case of that portion of any RAA (filed before August 5, 1997) which relates to the deductibility of a bad debt or the deductibility of a loss from a worthless security: (1) Code Sec. 6227(a)(2) does not apply; (2) the period for filing a Code Sec. 6228 petition with respect to such request will not expire before the date that is six months after August 5, 1997 (February 5, 1998); and (3) such a petition may be filed without regard to whether there was a notice of the beginning of an administrative proceeding or an FPAA.

Act Sec. 1243(a), adding Code Sec. 6227(e); Act Sec. 1243(b). Law at ¶ 5631. Committee Report at ¶ 12,390.

Availability of Innocent Spouse Relief

¶ 451

Background

Pursuant to Code Sec. 6013(e), an innocent spouse may be relieved of any liability for tax, penalties, and interest if certain conditions are met. However, prior to the enactment of a new jurisdictional provision in the Taxpayer Relief Act of 1997, the spouse of a partner in a TEFRA partnership did not have access to a judicial forum in which to raise the innocent spouse defense with respect to any tax or interest relating to the investment in the TEFRA partnership.

Innocent spouse rule expanded to encompass TEFRA proceedings.—The Act provides an individual taxpayer with both a prepayment and a refund forum in which to raise the innocent spouse defense under Code Sec. 6013(e) with respect to liabilities, penalties, and other additions to tax attributable to the

adjustment of TEFRA partnership items. The provision thus makes innocent spouse relief more uniformly available.

Prepayment forum. If the spouse of a partner in a TEFRA partnership asserts that the innocent spouse rules apply with respect to a liability attributable to any adjustment to a partnership item, then the spouse may file a request for an abatement of the assessment with the IRS. The spouse must file the request within 60 days after the notice of a computational adjustment has been mailed by the IRS. Upon receipt of the request, the IRS must abate the assessment. If the IRS chooses to reassess the abated tax, it then has 60 days after the date of the abatement in which to make any reassessment. In such a scenario, the regular deficiency procedures apply (Code Sec. 6230(a)(3)(A)).

If the taxpayer claiming innocent spouse relief files a Tax Court petition under Code Sec. 6213 with respect to the request for abatement, the Tax Court can determine only whether the innocent spouse requirements have in fact been satisfied. For purposes of this determination, the treatment of the TEFRA partnership items under the settlement, the final partnership administrative adjustment (FPAA) or the court decision that gave rise to the liability in question is conclusive (Code Sec. 6230(a)(3)(B)).

Refund forum. The Act also provides that the spouse of a partner in a TEFRA partnership can file a claim for refund on the ground that the IRS failed to relieve the spouse under the innocent spouse rules from a liability attributable to an adjustment to a partnership item (Code Sec. 6230(c)(5)(A)). The claim must be filed within six months after the date on which the IRS mails the notice of computational adjustment to the spouse (Code Sec. 6230(c)(5)(B)). If the administrative claim is disallowed, the spouse can then file a refund suit with respect to the claim within the two-year period specified by Code Sec. 6230(c)(3) and Code Sec. 6532(a) (Code Sec. 6230(c)(5)(C)). For purposes of the claim or suit, the treatment of the TEFRA partnership items under the settlement, the FPAA or the court decision that gave rise to the liability in question is conclusive (Code Sec. 6230(c)(5)(D)).

Effective date. The provision applies to partnership tax years beginning after September 3, 1982, and applies to any partnership tax year ending after this date if the partnership, each partner, and each indirect partner requests such application and the IRS consents to such application.

Act Sec. 1237(a), adding Code Sec. 6230(a)(3); Act Sec. 1237(b), adding Code Sec. 6230(c)(5); Act Sec. 1237(c)(1), amending Code Sec. 6230(a)(1); Act Sec. 1237(c)(2), amending Code Sec. 6503(a); Act Sec. 1237(d). Law at ¶ 5635 and 5677. Committee Report at ¶ 12,360.

Determination of Penalties at Partnership Level

¶ 453

Background

Under prior law, Code Sec. 6221 required that the tax treatment of any partnership item be determined at the partnership level. The definition of a partnership item included only those items required to be taken into account under Code Sec. 1 through Code Sec. 1563. Penalties, imposed by Code Sec. 6651 through Code Sec. 6724, could only be asserted against a partner at the partner level through the application of deficiency procedures following the completion of the unified partnership-level proceeding. This requirement of multiple, partner-level

Background

penalty assessments increased the IRS's administrative burden and significantly expanded the Tax Court's case load.

Penalties determinable at partnership level.—Any penalties, additions to tax or additional amounts attributable to an adjustment to a TEFRA partnership item can now be determined in a partnership-level proceeding. The partnership-level determination regarding the applicability of the penalty or other addition to tax is conclusive. However, individual partners may timely assert any applicable partner-level defenses or challenges to the computational adjustment amount in a refund proceeding or a Tax Court proceeding.

Effective date. The provision is effective for partnership tax years ending after August 5, 1997.

Act Sec. 1238(a), amending Code Sec. 6221; Act Sec. 1238(b), amending Code Sec. 6226(f), Code Sec. 6230(a)(2)(A)(i), (a)(3)(A) and (B), (c)(1)(A) and (B), (c)(2)(A), (c)(4), and (c)(5)(A) and (D), and adding Code Sec. 6230(c)(1)(C); Act Sec. 1238(c). Law at ¶ 5625, 5629 and 5635. Committee Report at ¶ 12,365.

Tax Court Jurisdiction

¶ 455

Background

Improper deficiency assessments and collection activities by the IRS that are attributable to partnership items may be enjoined during the 150-day period for filing a petition or during the pendency of the Tax Court proceeding. Prior to the Taxpayer Relief Act of 1997, it was not clear whether such an injunction could be filed in the Tax Court. In addition, the law was unclear concerning the standing of a partner to assert, before the Tax Court, that the period of limitations for assessing any tax attributable to partnership items had expired with respect to that partner.

Tax Court may enjoin premature deficiency assessments attributable to partnership items.—If the IRS makes an assessment or tries to collect a deficiency attributable to a partnership item during the 150-day period for filing a petition or during the pendency of any Tax Court proceeding, the Tax Court has jurisdiction to enjoin the improper action. However, the Tax Court's jurisdiction can be exercised only if a timely petition for a readjustment of the partnership items for the tax year has been filed and jurisdiction exists only with respect to the adjustments that are the subject of such petition.

In addition, a partner may participate in an action or file a petition for readjustment for the sole purpose of asserting that the period of limitations for assessing any tax attributable to partnership items has expired for that partner. The court with jurisdiction over the underlying action will consider the partner's assertion (Code Sec. 6226(d)(1)). The Tax Court has jurisdiction to determine overpayments with respect to affected items.

The Act also provides rules for determining the proper venue for an appeal of a declaratory judgment by the Tax Court on the treatment of items other than partnership items with respect to an oversheltered return (see ¶ 431). In such

situations, the decision is subject to review by the U.S. Court of Appeals for the circuit in which (1) the legal residence of a petitioner that is not a corporation is located or (2) the principal place of business or office of a corporate petitioner is located.

Effective date. These amendments apply to partnership tax years ending after August 5, 1997.

Act Sec. 1239(a), amending Code Sec. 6225(b); Act Sec. 1239(b), amending Code Sec. 6226(d)(1); Act Sec. 1239(c), amending Code Sec. 6230(d)(6) and Code Sec. 6512(b)(3); Act Sec. 1239(d), amending Code Sec. 7482(b)(1); Act Sec. 1239(e), amending Code Sec. 7459(c), adding Code Sec. 6501(o)(3), and amending Code Sec. 7421(a); Act Sec. 1239(f). Law at ¶ 5627, 5629, 5635, 5675, 5683, 5715, 5727 and 5735. Committee Report at ¶ 12,370.

Treatment of Premature Petitions

¶ 457

Background

The Tax Matters Partner (TMP) has the exclusive right to file a petition for a readjustment of partnership items within the 90-day period following the issuance of a notice of a final partnership administrative adjustment (FPAA). If the TMP does not file a petition within this 90-day period, certain other partners (i.e., notice partners, as defined by Code Secs. 6223(a) and 6231(a)(8), and five-percent groups, as defined by Code Sec. 6231(a)(11)) are permitted to file a petition within the 60-day period following the close of the aforementioned 90-day period.

Prior to the Taxpayer Relief Act of 1997, if a notice or five-percent partner filed a petition during the 90-day period, but no notice was filed by the tax matters partner during that period, and no notice was filed during the 60-day period, judicial review of the FPAA was foreclosed. The petition filed during the 90-day period was not considered timely filed because it was not filed during the 60-day period following the 90-day period.

Treatment of premature petitions for readjustment of final partnership administrative adjustment.—Within 90 days after notice of a final partnership administrative adjustment (FPAA), a tax matters partner (TMP) may petition for a readjustment of the FPAA. If the TMP fails to do so, any notice partner (or 5-percent group) may file a petition within 60 days after the close of the 90-day period. Under the Taxpayer Relief Act of 1997, a petition for readjustment filed by a notice partner or 5-percent group during the 90-day period is treated as filed on the last day of the 60-day period after the close of the 90-day period, so long as no other action is brought during the 60-day period.

> **Example.** An FPAA was mailed to a partnership. During the 90-day period following the mailing of the FPAA, the TMP does not file a petition for redetermination of the FPAA. However, during that 90-day period, a 5-percent group files a petition. During the 60-day period following the 90-day period, no other petition is filed. The 5-percent group's petition will be considered timely filed on the last day of the 60-day period and the action will continue in court.

Effective date. The provision is effective with respect to petitions filed after August 5, 1997.

Act Sec. 1240(a), redesignating Code Sec. 6226(b)(5) as Code Sec. 6226(b)(6), and adding new Code Sec. 6226(b)(5); Act Sec. 1240(b). Law at ¶ 5629. Committee Report at ¶ 12,375.

Bonds in Case of Appeals

¶ 459

Background

A partnership must file a bond in order to stay the collection of any determined deficiencies pending the partnership's appeal of the Tax Court's decision in a TEFRA proceeding. Prior to the Taxpayer Relief Act of 1997, the amount of this bond had to be based on the Tax Court's estimate of the aggregate deficiencies of *all* of the partners in the partnership who would be affected by the court's decision, a calculation that was difficult to determine with accuracy. Deficiencies specifically included interest, additional amounts, or additions to tax. Penalties were not specifically mentioned in the Code.

Bond amount based on deficiencies of partners filing appeal.—The amount of the bond necessary to stay the collection of deficiencies pending an appeal of the Tax Court's decision in a TEFRA proceeding is modified. The amount of the bond is calculated by the Tax Court based on any deficiencies attributable to partnership items determined in the Tax Court decision. The Tax Court's estimate of the deficiencies is based on the aggregate liability of the parties to the action. Bond amounts are no longer based on an estimate of the aggregate of all partners' deficiencies. Estimates of deficiencies are to include any applicable interest, penalties, additional amounts, or additions to tax. Penalties were not specifically mentioned by the Code prior to the amendment.

The Conference Committee Report suggests that the amount of the bond can be estimated by applying the highest individual rate to the total adjustments determined by the Tax Court and doubling that amount to take into account the applicable interest and penalties.

Effective date. The provision is applicable to partnership tax years beginning after September 3, 1982, and applies to partnership tax years ending after this date if the partnership, each partner, and each indirect partner requests such application and the IRS consents to such application.

Act Sec. 1241(a), amending Code Sec. 7485(b); Act Sec. 1241(b). Law at ¶ 5737. Committee Report at ¶ 12,380.

Suspension of Interest

¶ 461

Background

Interest on a deficiency is generally suspended when a taxpayer executes a settlement agreement with the IRS and waives the restrictions on assessments and collections, and the IRS does not issue a notice and demand for payment of such deficiency within 30 days.

Background

While processing settlement agreements and assessing the tax due takes a substantial amount of time in TEFRA cases, prior to the Taxpayer Relief Act of 1997, a partner in such a partnership was not afforded any relief from interest during this period. The interest on a deficiency resulting from an adjustment of partnership items in TEFRA proceedings was not suspended.

Interest suspended during period of computational adjustments.—Interest on a deficiency that results from an adjustment of partnership items in a TEFRA settlement is suspended where the delay arises from making a computational adjustment relating to such settlement. According to the House Committee Report, processing settlements and assessing the tax due in a TEFRA case is time consuming and, prior to the Act, taxpayers were not afforded any relief from interest during this period.

Effective date. The provision is effective with respect to adjustments relating to partnership tax years beginning after August 5, 1997.

Act Sec. 1242(a), amending Code Sec. 6601(c); Act Sec. 1242(b). Law at ¶ 5685. Committee Report at ¶ 12,385.

OTHER PARTNERSHIP PROVISIONS

Self-Employment Tax on Limited Partners

¶ 463

Background

Under the Self-Employment Contributions Act (SECA), an individual's net earnings from self-employment is subject to taxes for old-age, survivor, and disability insurance (OASDI) and the Medicare hospital insurance (HI). A general partner is treated as self-employed (see Rev. Rul. 69-184, 1969 CB 256) and is subject to the SECA tax rate of 15.3 percent (12.4 percent for OASDI plus 2.9 percent for HI (in 1997)) on the first $65,400 of self-employment income. Amounts over this maximum threshold are subject only to the HI tax rate of 2.9 percent.

A general partner's net earnings from self-employment (NESE) generally include the partner's distributive share of income from any trade or business of the partnership, adjusted downwards for certain passive income such as rents, dividends, and interest. If a general partner's distributive share is a net loss, then such loss may be deducted from the partner's NESE.

In contrast, under Code Sec. 1402(a)(13), the distributive share of a *limited* partner is generally *excluded* from NESE, except to the extent that this share is a Code Sec. 707(c) guaranteed payment. Guaranteed payments are amounts paid to a partner for services rendered on behalf of the partnership, determined without regard to the income of the partnership. Limited partners are excepted from the self-employment tax rule under the theory that they are more like passive investors than true partners.

When Congress first enacted the Code Sec. 1402(a)(13) limited partner exclusion, many state laws did not permit a limited partner to actively participate in the partnership's trade or business. However, under the Uniform Limited Partnership Act and other state laws, a limited partner is now freer to participate in the partnership without being recharacterized as a general partner for liability pur-

Background

poses. Furthermore, limited liability companies (LLCs), which were unknown at the time of the enactment of Code Sec. 1402(a)(13), are now viable business entities in all 50 states and the District of Columbia. LLCs can generally elect, pursuant to the Code Sec. 7701 "check-the-box" regulations (Reg. §§301.7701-1 through 301.7701-3), to be treated as partnerships for federal income tax purposes. An LLC generally makes no distinction between general and limited members as a matter of state law. Thus, the terms "general partner" and "limited partner" no longer accurately distinguish between active and passive participants.

In an effort to resolve mounting questions involving the self-employment tax status of limited partners and LLC members, on January 13, 1997, the Treasury Department made two significant decisions. First, it withdrew a previously released, but controversial, proposal concerning the applicability of the self-employment tax rules to certain members of an LLC; and, second, it proposed amendments to current Reg. § 1.1402(a)-2. According to the IRS, the new proposals were an attempt to establish a single set of "functional" rules that apply identical standards to all entities classified as partnerships for federal tax purposes. The proposed amendments would allegedly resolve the issue by classifying general and limited partners on the basis of functional tests rather than historic state law definitions.

Under the proposals, a "limited partner," for purposes of Code Sec. 1402(a)(13), would be any person classified as a partner unless the partner (1) has personal liability for the debts or obligations of the partnership by reason of being a partner, (2) has authority to enter into contracts on behalf of the partnership, or (3) participates in the partnership's trade or business more than 500 hours annually.

However, a special rule provides that service partners in professional service partnerships will never be treated as limited partners for NESE purposes. If substantially all of the activities of a partnership involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science or consulting, any individual who provides more than a *de minimis* amount of services as part of that trade or business would not be considered a limited partner.

Critics of the proposal, maintaining that the proposed Code Sec. 1402 self-employment tax regulations would impose new taxes on partners and require more recordkeeping, urged the IRS to withdraw its proposed regulation defining "limited partner" for self-employment tax purposes. Commentators and witnesses at IRS hearings noted that limited partners have always participated in partnership affairs and that Code Sec. 1402 provides no foundation for the proposal's 500-hour test, as is the case with the material participation test under Code Sec. 469. Furthermore, the legislative history of Code Sec. 1402 provides no support for the proposal's attempt to subject all of the earnings of partners working for certain service providers to the self-employment tax. These critics argued that only those limited partner earnings that constitute reasonable compensation for services actually rendered to or on behalf of the partnership should be subject to the self-employment tax.

Congressional legislators, with support from many small business groups, began characterizing the proposed regulation as an attempt by the IRS and the Treasury Department to legislate, rather than to interpret Code Sec. 1402(a)(13). The most active of these critics, citing the Regulatory Flexibility Act (5 USC

Background

Chapter 6), as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (P.L. 104-121), also addressed the failure of the IRS and the Treasury to comply with federal procedures for legislative regulations and for regulations that might cause a significant economic impact on many small businesses.

IRS requested to withdraw proposed amendments to Reg. § 1.1402(a)-2.—The IRS is prohibited from issuing temporary or final regulations relating to the definition of a limited partner for employment tax purposes that would be effective before July 1, 1998. The legislative history indicates that Congress wants the IRS to withdraw the controversial proposed regulation, Prop. Reg. § 1.1402(a)-2, which would impose a tax on limited partners. A "sense of the Senate" resolution in the Senate amendment expressed dissatisfaction with the proposed rule, noting that Congress, not the Treasury or the IRS, should determine the law governing self-employment income for limited partners (S. 949, Sec. 734, offered as Senate Floor Amendment No. 584).

The Act's resolution accommodates the Senate's expressed concern that the IRS has exceeded its regulatory and administrative authority in the area of self-employment taxes. The Code provides that a limited partner's self-employment income includes only guaranteed payments for services (Code Sec. 1402(a)(13)). In contrast, the proposed regulation would extend self-employment taxes to other limited partners with personal liabilities for partnership debts or who participate in the partnership's business (Prop. Reg. § 1.1402(a)-2(h)). In the view of the Senate, the expanded definition of a limited partner will have a substantial impact on the tax liability of affected individuals and their entitlement to social security benefits, and is thus a significant policy issue best left to Congress.

The moratorium applies to any temporary or final regulation relating to the definition of a limited partner under Code Sec. 1402(a)(13) issued or made effective before July 1, 1998.

PRACTICAL ANALYSIS. Michael Cohen of Levun, Goodman & Cohen, Northbrook, Illinois, notes that, earlier this year, Treasury issued a second set of proposed regulations designed to determine when a partnership or a member in an LLC is to be regarded as a "limited partner" for purposes of excluding partnership or LLC income from self-employment tax under Code Sec. 1402(a)(13). These proposed regulations have been the target of complaints from members of Congress, certain sectors of the business community and certain tax professionals. The proposed regulations, for example, make it difficult for an LLC manager to avoid self-employment tax on the portion of his LLC income attributable to his capital infused into the LLC. Act Sec. 935 of the Taxpayer Relief Act of 1997 provides Congress with an opportunity to examine this area by prohibiting Treasury from issuing temporary or final regulations under Code Sec. 1402(a)(13) before July 1, 1998.

Effective date. This provision is effective as of August 5, 1997.

Act Sec. 935. Law at ¶ 7015. Committee Report at ¶ 10,675.

Closing of Partnership Tax Year; Deceased Partner

¶ 465

Background

Prior to the Taxpayer Relief Act of 1997, a partnership's tax year closed with respect to a partner whose entire interest was either sold, exchanged, or liquidated. The tax year, however, generally did not close upon the death of a partner. Consequently, a decedent's entire share of items of income, gain, loss, deduction, and credit for the partnership year in which the death occurred was taxed to the decedent's estate or to his successor-in-interest rather than to the decedent on his final income tax return (*S. Hesse Estate,* 74 TC 1307, Dec. 37,240).

Closing of tax year with respect to deceased partner.—Under the new law, the tax year of a partnership closes with respect to a partner whose entire interest in the partnership terminates, whether by death, liquidation or otherwise (Code Sec. 706(c)(2)(A)). The Conference Committee Report clarifies that the current law with respect to the effect upon the partnership's tax year of a transfer of a partnership interest by a debtor to the debtor's estate (under Chapter 7 or 11 of Title 11, relating to bankruptcy) remains unchanged.

Planning Note. In 1998, partners may want to re-evaluate existing agreements that provide for the sale or exchange of their partnership interests upon death. If these agreements were made to close the partnership tax year with respect to a deceased partner prior to the Act, they are no longer necessary.

PRACTICAL ANALYSIS. Michael Cohen of Levun, Goodman & Cohen, Northbrook, Illinois, observes that the Taxpayer Relief Act of 1997 eliminates the rule that a partnership year does not close upon the death of a partner, effective for partnership tax years beginning after December 31, 1997. Previously, a decedent partner's share of income generated by the partnership during the year in which he died would be reported by his successor in interest (such as his estate or his widow). In some situations, if the estate were in a lower income tax bracket than the decedent partner, this rule caused a reduction in income taxes. In other situations, the impact of the rule on the unwary caused a mismatching of income and deductions.

For example, assume that a partner in a professional service partnership had a $75,000 distributive share of partnership income as of the date of his death, and as of that time had incurred personal mortgage interest and taxes of $30,000. Upon his death, the partnership year did not close and the $75,000 of income would be reported by the partner's successor in interest, whereas his mortgage interest and taxes would be reported on his final individual income tax return. In circumstances where his successor in interest was his estate, this could create a situation where the estate was required to report the partnership income without any significant offsetting deductions, and the decedent's final individual income tax return reported deductions that did not offset any significant amount of income. The wary taxpayer who was married would often designate his spouse as his successor in interest

for federal tax purposes (if permitted by the partnership). This would allow the decedent's partnership income, along with his mortgage interest and taxes, to be reported on the final joint return for the decedent and his spouse.

For partnership tax years beginning after December 31, 1997, the death of a partner causes a closing of the partnership's tax year with respect to the deceased partner and an inclusion of this income on the decedent's final individual income tax return. Consequently, income attributable to the decedent partner's partnership interest must be allocated between the pre- and post-death periods. Pursuant to the regulations under Code Sec. 706, this allocation is made by an interim closing of the partnership's books or, if all partner's agree, on a pro rata basis based upon the number of days in each period.

Effective date. These provisions apply to partnership tax years beginning after December 31, 1997.

Act Sec. 1246(a), amending Code Sec. 706(c)(2)(A); Act Sec. 1246(b), amending Code Sec. 706(c)(2); Act Sec. 1246(c). Law at ¶ 5219. Committee Report at ¶ 12,415.

Residence of a Partnership

¶ 467

Background

A "domestic" partnership is a partnership created or organized in the United States, or under the laws of the United States or of any state, and a "foreign" partnership is any partnership that is not a domestic partnership. However, for U.S. tax purposes, business activities between persons may create partnerships without formal agreements and it was often difficult to determine whether such a tax partnership was "created or organized" in the United States. Difficult issues also arose when attempting to apply the "created or organized" test to a foreign entity that domesticated under the laws of a U.S. state.

Regulations authorize the IRS to define foreign and domestic partnerships.—The IRS is authorized to issue regulations defining whether a partnership will be considered domestic or foreign. The Conference Committee Report clarifies that any regulations issued under this provision will apply only to partnerships created or organized after the date that the regulations are filed with the Federal Register (or, if earlier, the date of a public notice substantially describing the expected content of the regulations). The Conference Committee Report also indicates that the general rule for classifying partnerships as domestic or foreign will continue to be the place where the partnership is created or organized (or the law under which it is created or organized) and that the regulations are expected to provide a different classification only in unusual cases. In addition, the regulations are to avoid period-by-period reclassifications of partnerships.

Effective date. This provision is generally effective on August 5, 1997. However, any regulations issued with respect to this provision are applicable to partnerships created or organized after the date determined under Code Sec.

7805(b), Retroactivity of Regulations, without regard to the exception for promptly issued regulations under Code Sec. 7805(b)(2).

Act Sec. 1151(a), amending Code Sec. 7701(a)(4); Act Sec. 1151(b). Law at ¶ 5745. Committee Report at ¶ 11,815.

Magnetic Media Reporting

¶ 469

Background

Most entities that file a large number of documents with the IRS must do so using magnetic media. While partnerships were permitted to provide their Forms 1065 and copies of their partners' Schedules K-1 to the IRS on magnetic media, prior to the Taxpayer Relief Act of 1997, no partnerships were required to do so.

Large partnership returns must be provided on magnetic media.—A partnership with more than 100 partners is required to provide the partnership's tax return (Form 1065), as well as copies of the schedule sent to each partner (Schedule K-1), to the IRS on magnetic media. Congress believes that conforming the reporting provisions for large partnerships to the generally applicable information reporting rules will facilitate the integration of partnership information into the already existing data systems. Partnerships with 100 or fewer partners have the option, but not the obligation, to utilize magnetic media.

Effective date. The provision is effective for partnership tax years ending on or after December 31, 1997.

Act Sec. 1224, amending Code Sec. 6011(e)(2). Law at ¶ 5573. Committee Report at ¶ 12,285.

S CORPORATIONS

Electing Small Business Trusts

¶ 473

Background

Under the Small Business Job Protection Act of 1996 (P.L. 104-188), certain trusts, referred to as electing small business trusts, are allowed to hold stock in an S corporation. In order to qualify, all electing small business trust beneficiaries are required to be individuals or estates eligible to be S corporation shareholders. Any trust exempt from tax may not qualify as an electing small business trust. Prior to the Taxpayer Relief Act of 1997, charitable remainder annuity trusts and charitable remainder unitrusts were not specifically prohibited from qualifying as an electing small business trust.

Qualification as electing small business trust.—Charitable remainder unitrusts (CRUTs) and charitable remainder annuity trusts (CRATs) cannot qualify as electing small business trusts. All beneficiaries of an electing small business trust must be individuals or estates eligible to be S corporation shareholders. While CRUTs and CRATs may provide income to individual beneficiaries for a term of years, they must also provide a remainder interest to a charitable organization.

Effective date. The provision is effective for tax years beginning after December 31, 1996.

Act Sec. 1601(c)(1), amending Code Sec. 1361(e)(1)(B); Act Sec. 1601(j). Law at ¶ 5375. Committee Report at ¶ 13,525.

Post-Termination Date Transition Period

¶ 475

Background

Under prior law, the effective date for the expanded post-termination period for former S corporations was tax years beginning after December 31, 1996. The expanded post-termination period includes the 120-day period beginning on the date of any determination pursuant to a taxpayer audit following the termination of the S corporation's election that adjusts a subchapter S item of income, loss, or deduction that arose while the entity was treated as an S corporation. During a former S corporation's post-termination transition period, distributions are treated as being made by an S corporation, rather than by a C corporation.

Former S corporation post-termination transition period.—The new law clarifies that the expanded post-termination transition period provided to former S corporations under the Small Business Job Protection Act (P.L. 104-188) is effective for determinations made after December 31, 1996, rather than for determinations with respect to tax years beginning after December 31, 1996. However, the 120-day period beginning on the date of any determination described under Code Sec. 1377(b)(1)(B) will not expire before the end of a period extending 120 days from August 5, 1997. Distributions made by a former S corporation during its post-termination transition period are treated in the same manner as if made by an S corporation.

Effective date. The provision applies to determinations made after December 31, 1996.

Act Sec. 1601(c)(2); Act Sec. 1601(j). Law at ¶ 7076. Committee Report at ¶ 13,530.

Qualified Subchapter S Subsidiaries

¶ 477

Background

In general, a qualified subchapter S subsidiary (QSSS) is not treated as a corporation for federal tax purposes and all assets, liabilities, and items of income, deduction, and credit are treated as the assets, liabilities, and items of income, deduction, and credit of the parent S corporation. Where an election is made to treat an existing corporation as a QSSS, the subsidiary is deemed to have liquidated immediately before the election is effective. Prior to the Taxpayer Relief Act of 1997, the IRS did not have specific authority to issue regulations that would allow the separate corporate existence of a QSSS to be taken into account for purposes of the Internal Revenue Code. Additionally, there was no specific authority to issue regulations providing exceptions to the general rule that the QSSS election is treated as a deemed Code Sec. 332 liquidation of the subsidiary.

Regulations regarding qualified subchapter S subsidiaries.—The IRS is authorized to provide by regulation instances where the separate corporate existence of qualified subchapter S subsidiaries (QSSS) may be taken into account. Thus, for example, where an S corporation owns 100 percent of the stock of a bank and elects to treat the bank as a QSSS, the IRS is authorized to write regulations that treat the bank as a separate legal entity for purposes of those Internal Revenue Code provisions applicable to banks.

The IRS is also authorized to draft regulations addressing the Code Sec. 332 liquidation of the subsidiary deemed to occur upon a QSSS election and the effects that the QSSS election has on consolidated returns.

Effective date. The provision is effective for tax years beginning after December 31, 1996.

Act Sec. 1601(c)(3), amending Code Sec. 1361(b)(3)(A); Act Sec. 1601(j). Law at ¶ 5375. Committee Report at ¶ 13,535.

Chapter 5

Corporations and Special Entities

ORGANIZATIONS AND REORGANIZATIONS

Extraordinary Dividends

¶ 501

Background

A corporate shareholder that receives an "extraordinary dividend" reduces the basis of the stock with respect to which the dividend was received by the nontaxed portion of the dividend (Code Sec. 1059). An extraordinary dividend is generally a dividend that equals or exceeds five percent of the taxpayer's adjusted basis in the stock for preferred stock, and 10 percent of the taxpayer's adjusted basis in the stock for all other stock. An extraordinary dividend results from, among other things, a non-pro rata redemption or a partial liquidation. Untaxed dividends arise because a corporate shareholder can generally deduct at least 70 percent of dividends received from another corporation (the deduction increases to an 80

Background

percent deduction, if at least 20 percent of the distributing corporation is owned by the corporate shareholders, and to a 100 percent deduction, if at least 80 percent of the distributing corporation is owned by the corporate shareholders (see Code Sec. 243)). If the necessary reduction in basis of stock exceeds the basis in the stock with respect to which an extraordinary dividend is received, the excess is taxed as gain, but, under prior law, not until the sale or disposition of the stock. The reduction in basis for this purpose occurred immediately before any sale or disposition of the stock.

In general, a distribution in redemption of stock was treated as a dividend, rather than as a sale of the stock, if it was essentially equivalent to a dividend (Code Sec. 302). The determination of whether a redemption was essentially equivalent to a dividend was made by applying the constructive ownership rules, including the option attribution rules of Code Sec. 318(a)(4). The rules relating to treatment of cash or other property received in a reorganization similarly considered the constructive ownership rules, including the option attribution rules (Code Sec. 356(a)(2)).

Gain recognition required for certain extraordinary dividends.—A corporate shareholder that receives an "extraordinary dividend" must reduce the basis of the stock with respect to which the dividend was received by the nontaxed portion of the dividend unless the stock was held for more than two years before the dividend was declared (Code Sec. 1059(a)). The reduction in basis of stock is treated as occurring at the beginning of the ex-dividend date of the extraordinary dividend to which the reduction relates. In addition, if the nontaxed portion exceeds basis, gain must be recognized (see below).

Gain recognized. When making the basis reduction on account of an extraordinary dividend, the nontaxed portion of the dividend cannot reduce basis below zero. Gain must be recognized in the tax year in which the extraordinary dividend is received to the extent that the nontaxed portion exceeds basis. Thus, immediate gain recognition is required in such case, as opposed to the former rule which allowed such gain to be deferred until the tax year in which the stock was sold or otherwise disposed of by the corporate shareholder. The gain recognized is treated as gain from the sale or exchange of the stock.

> **Example.** Alpha Corp. owns 81% of Beta Corp stock and Alpha has basis of $50,000 in that stock. In 1997, Alpha receives a $70,000 distribution from Beta in a non-pro rata distribution considered to be an extraordinary dividend. Since Alpha owns more than 80% of Beta, the entire $70,000 is untaxed and Alpha must reduce its basis in Beta stock by the amount of the untaxed extraordinary dividend. In 1997, Alpha must recognize gain of $20,000, the amount by which the untaxed distribution exceeds basis ($70,000, untaxed amount, less $50,000, basis).

Redemptions and reorganizations. A corporate shareholder must reduce the basis of stock by the nontaxed portion of any amount treated as a dividend received and recognize gain immediately when the nontaxed portion exceeds the basis of the shares surrendered with respect to certain redemptions of stock. In addition to any redemption which is part of a partial liquidation as described in Code Sec. 302(e) or which is not pro rata with respect to all the shareholders, the basis reduction and gain recognition rules now apply to any redemption that was treated as a dividend because the holding of options was treated as stock ownership

under the constructive stock ownership rules of Code Sec. 318(a)(4). Basis is reduced and gain is recognized in such cases whether or not the stock was held for more than two years. Further, in making the basis reduction for a redemption for which options were considered, only the basis in the redeemed stock is taken into account.

According to the House Committee Report, these provisions are at least in part a response to certain transactions (such as the well-publicized attempts of Seagram Corporation) in which taxpayers apparently have taken the position that option rights may have sufficient economic reality that they should be recognized as stock ownership for purposes of finding that a taxpayer has not meaningfully reduced its ownership despite a stock redemption. The redemption distributions would otherwise be treated as dividends, and the corporate dividends received deduction would eliminate tax on distributions received in a stock redemption. However, under the new provisions, gain would be required to be recognized as soon as the amounts received exceed basis.

Reorganizations or other exchanges involving amounts that are treated as dividends under Code Sec. 356 are treated as redemptions for purposes of applying the rules on redemptions described above. For example, if a recapitalization or other transaction that involves a dividend under Code Sec. 356 has the effect of a non-pro rata redemption or is treated as a dividend because the options are counted as stock, the basis reduction and gain recognition rules of Code Sec. 1059 apply.

Effective date. This provision is generally effective for distributions after May 3, 1995. However, under a transition rule, the provision does not apply to a distribution made pursuant to the terms of a written binding contract in effect on May 3, 1995, and at all times thereafter before such distribution, or pursuant to a tender offer outstanding on May 3, 1995. Further, in applying the new gain recognition rules to any distribution that is not a partial liquidation, a non-pro rata redemption, or a redemption that is treated as a dividend by reason of the holding of options, the date of September 13, 1995, is substituted for May 3, 1995, as the effective date for the provision and in applying the transition rule.

Act Sec. 1011(a), amending Code Sec. 1059(a)(2); Act Sec. 1011(b), amending Code Sec. 1059(e)(1); Act Sec. 1011(c), amending Code Sec. 1059(d)(1); and Act Sec. 1011(d). Law at ¶ 5337. Committee Report at ¶ 11,165.

Gain Recognition on Distributions of Controlled Corporation Stock

¶ 503

Background

Although a corporation is generally required to recognize gain on the distribution of property, and the shareholders who receive a distribution generally treat the receipt of property as a taxable event, certain exceptions exist. Nonrecognition of gain applies to certain spin-off type distributions of controlled corporation stock. If certain requirements are met, including restrictions relating to acquisitions and dispositions of stock of the distributing corporation ("distributing") or the controlled corporation prior and subsequent to a distribution, stock can be distributed without the recognition of gain by the corporate or the receiving shareholder (Code Sec. 355). However, under prior law nonrecognition was not affected by "distributing" dropping one of its businesses into a new corporation, spinning-off the new corporation and then the "distributing" shareholders transferring stock in "distrib-

Background

uting" in exchange for stock in an unrelated corporation. This is the so-called *Morris Trust* (66-2 USTC ¶ 9718) structure.

Gain recognition required on certain distributions of controlled corporation stock.—New requirements must be satisfied in order for a corporate "spin-off" to qualify for nonrecognition of gain.

A corporation that distributes its property to shareholders is generally required to recognize gain on the distribution as if the property had been sold for its fair market value (Code Sec. 311(b)). The shareholders who receive a distribution generally treat the receipt of property as a taxable event. For example, assume a corporation distributes property with an adjusted basis of $2 and a fair market value of $10. The corporation would recognize a gain of $8 as if it had sold the property, and the shareholders would have dividend income of $8, assuming the corporation had only $8 of earnings and profits. This general rule applies to the distribution of the stock of a subsidiary corporation, so that the distribution by a corporation of the stock of a subsidiary would cause the recognition of gain.

There are certain nonrecognition provisions which permit property to be distributed without incurring gain at the corporate level or by the shareholders receiving the property. One of these exceptions involves certain spin-off type distributions of stock of a controlled corporation. Provided that various requirements are met, including certain restrictions relating to acquisitions and dispositions of stock of the distributing corporation (distributing) or the controlled corporation (controlled) prior and subsequent to a distribution, stock can be distributed without the recognition of gain by the corporation or the shareholder under Code Sec. 355.

New restrictions have been adopted on the acquisition and disposition of the stock of the distributing or controlled corporation. If either the controlled or distributing corporation is acquired pursuant to a plan or arrangement in existence on the date of distribution, gain is generally recognized by the distributing corporation as of the date of the distribution.

One of the purposes of these restrictions is to limit the ability of taxpayers to follow the structure of *Morris Trust* (CA-4, 66-2 USTC ¶ 9718, 367 F2d 794) and, in effect, dispose of a portion of its business to new shareholders without the recognition of gain. Under the new rules the recognition of income can be avoided if the historical shareholders retain more than a 50 percent ownership interest in the distributing and acquiring corporations. In *Morris Trust*, after a Code Sec. 355 distribution, the distributing corporation merged with an unrelated corporation; however, the shareholders of the distributing corporation controlled greater than 50 percent of the shares of the merged corporation. Therefore, the result in *Morris Trust* would not have been changed if the new rules had applied.

Recognition of gain. In the case of an acquisition of a controlled or a distributing corporation, the amount of gain recognized by the distributing corporation is the amount of gain that the distributing corporation would have recognized had stock of the controlled corporation been sold for fair market value on the date of distribution. This gain is treated as long-term capital gain (House Committee Report). No adjustment to the basis of the stock or assets of either corporation is allowed by reason of the recognition of the gain.

Acquisition of a controlled corporation. Whether a corporation is acquired is determined under rules similar to those of Code Sec. 355(d), except that acquisitions are not restricted to so-called "purchase" transactions. Thus, an acquisition occurs if one or more persons acquire directly or indirectly 50 percent or more of the vote or value of the stock of the controlled or distributing corporation pursuant to a plan or arrangement (Code Sec. 355(e)(2)(A)).

Acquisitions occurring within the four year period beginning two years before the date of distribution are presumed to have occurred pursuant to a plan or arrangement. Taxpayers can avoid gain recognition by showing that an acquisition occurring during this four year period was unrelated to the distribution (Code Sec. 355(e)(2)(B)).

If the assets of the distributing or controlled corporation are acquired by a successor in an "A", "C" or "D" reorganization (or any transaction described in Code Sec. 368(a)(1)(A), (C) or (D)) or any other transaction specified in regulations, the shareholders (immediately before the acquisition) of the corporation acquiring such assets are treated as acquiring stock in the corporation from which the assets were acquired (Code Sec. 355(e)(3)(B)). Regulations, according to the Conference Committee Report, may subject other asset transfers to this rule. However, if the former shareholders of distributing or controlled receive (directly or indirectly) stock in a successor or in a new controlling corporation, then the stock is not treated as acquired stock if it is attributable to the shareholders' stock in distributing or controlled and was not acquired as part of a plan or arrangement to acquire 50 percent or more of the successor or other corporation (Code Sec. 355(e)(3)(A)).

> **Example (1).** Parent Corporation distributes the stock of its wholly owned subsidiary, SubCo, to its shareholders. Parent has a $75,000 basis in SubCo, and SubCo's value is $25,000. One year later an unrelated corporation purchases 51 percent of SubCo stock. Since a 50 percent or greater interest in the controlled corporation is acquired in the four-year period beginning two years before the distribution date, it is presumed, unless established otherwise, that the acquisition and distribution are pursuant to a plan or arrangement. Parent must therefore recognize gain of $50,000, the amount of net gain which would have been recognized if all the assets of SubCo were sold for fair market value.

A plan or series of related transactions does not cause the recognition of gain if, immediately after the completion of the plan or transactions, the distributing corporation and all the controlled corporations are members of a single affiliated group, as defined by Code Sec. 1504. For this purpose the definition of an affiliated group does not include the exceptions in Code Sec. 1504(b) (Code Sec. 355(e)(2)(C)). Thus, for example, a tax-exempt organization, life insurance company, foreign corporation, Real Estate Investment Trust (REIT), or Regulated Investment Company (RIC) could be considered a member of an affiliated group in determining whether the distributing and controlled corporations are in the same affiliated group.

> **Example (2).** Parent Corporation owns all the stock of Subco, and Subco owns all the stock of Subco1, a foreign corporation. Parent is merged into an unrelated corporation, AcqCorp, and as part of a plan, all the Subco1 stock is distributed by Subco to AcqCorp in a transaction that otherwise qualifies under Code Sec. 355. The former shareholders of Parent will own less than 50 percent of AcqCorp. Although the distribution of the Subco1 stock is part of a plan in which the ownership of the affiliated group has changed, it is not

considered a plan requiring the recognition of gain for the distribution. This is because the distributing corporation, Subco, and the controlled corporation, Subco1, remain part of a single affiliated group after the distribution. The fact that Subco1 is a foreign corporation is disregarded in determining affiliated group status.

These provisions do not apply to a distribution that would otherwise be subject to Code Sec. 355(d), which imposes corporate level tax on certain disqualified distributions (Code Sec. 355(e)(2)(D)). Nor do these provisions apply to a distribution pursuant to a title 11 bankruptcy or similar case (as defined in Code Sec. 368(a)(3), Code Sec. 355(e)(4)).

Unless the stock held before an acquisition was acquired pursuant to a plan to transfer 50 percent control of either the controlled or distributing corporation, the following acquisitions are *not* considered acquisitions of a controlled corporation for purposes of these rules (Code Sec. 355(e)(3)):

(1) the acquisition of stock in any controlled corporation by the distributing corporation (e.g., the drop down of property by the distributing corporation to the controlled corporation in exchange for its stock);

(2) the acquisition by a person of stock in any controlled corporation by reason of holding stock or securities in the distributing corporation;

(3) the acquisition by a person of stock in any successor corporation of the distributing corporation or any controlled corporation by reason of holding stock or securities in the distributing or controlled corporation (e.g., the receipt by a distributing corporation shareholder of controlled corporation stock in a split-off distribution in which the shareholder did not own 50 percent of distributing but owns 50 percent of controlled); and

(4) the acquisition of stock in a corporation if shareholders, who own directly or indirectly stock possessing more than 50 percent of the total combined voting power and total value of all classes of stock in either the distributing corporation or any controlled corporation before the acquisition, own directly or indirectly stock possessing such vote and value in that distributing or controlled corporation after the acquisition (e.g., the receipt by the former shareholders of distributing or controlled corporation of 50 percent or more of a successor corporation in a merger of distributing or controlled corporations).

For purposes of these provisions:

(1) any reference to a controlled corporation or a distributing corporation also refers to any predecessor or successor of the corporation (Code Sec. 355(e)(4)(D));

(2) the attribution rules of Code Sec. 318(a)(2) apply in determining whether a person holds stock or securities in a corporation, except Code Sec. 318(a)(2)(C) is applied without regard to the phrase 50 percent or more in value, so that attribution from corporations is applied regardless of the amount of stock ownership (Code Sec. 355(e)(4)(C)(ii), see Example (5), below); and

(3) the aggregation rules of Code Sec. 355(d)(7)(A) apply so that all related persons, within the meaning of Code Sec. 267(b) or Code Sec. 707(b)(1), are treated as one person (Code Sec. 355(e)(4)(C)(i)).

Example (3). Kathy Kreer owns all the stock of ABC Corporation and also owns all the stock of MEG Corporation. ABC has a wholly-owned subsidi-

ary, Subco1. As part of a plan, ABC distributes the stock of Subco1 to Kreer in a transaction that otherwise qualifies under Code Sec. 355, and ABC then merges into MEG. Since Kreer now owns directly or indirectly all the stock of Subco1 and MEG, the successor to ABC, the distributing corporation, this is not considered an acquisition requiring gain recognition.

Example (4). The same facts as Example (3), above, except that as part of the plan Kreer had obtained all the stock in ABC one day before the distribution of Subco1. Since direct ownership of 50 percent or more of the distributing corporation was acquired as part of a plan, the recognition of gain would be required for the transaction.

Example (5). The same facts as Example (3), above, except that instead of one individual owning all the stock in ABC and MEG, ten individuals own 10 percent of the stock in both ABC and MEG at all times during the transactions. The Subco1 stock would be spun-off to the ten individuals, who would own directly or indirectly 50 percent or more of the stock of the distributing and the controlled corporations before and after the transaction. This is not considered an acquisition requiring gain recognition.

Regulations. The IRS is specifically authorized to prescribe regulations as necessary to carry out the purposes of these provisions, including regulations to provide for the application of the provisions in the case of multiple transactions and more than one controlled corporation. In determining whether a 50 percent interest has been acquired, regulations may also be provided applying rules similar to Code Sec. 355(d)(6), that is suspending the holding period for any stock or security for which a taxpayer's risk of loss is substantially diminished through devices such as options and short sales (Code Sec. 355(e)(5)).

Intragroup distributions. Except as provided in regulations, in the case of distributions of stock within an affiliated group of corporations (as defined in Code Sec. 1504(a)), the nonrecognition rules of Code Sec. 355 do not apply to any distribution of the stock of one member of the group to another member if one or more persons acquire directly or indirectly 50 percent or more of the vote or value of the stock of the controlled or distributing corporation pursuant to a plan or arrangement (Code Sec. 355(f)).

Example (6). MooreCo, the parent corporation in an affiliated group, owns all the stock of ABC Corporation. ABC has a wholly-owned subsidiary Subco. As part of a plan, ABC distributes the stock of SubCo to MooreCo, MooreCo distributes the stock of SubCo to its shareholders. MooreCo is then merged into NewCo with the shareholders of MooreCo owning only 40 percent of NewCo stock. The spin-off of SubCo to MooreCo is part of a plan by which SubCo is distributed outside of the affiliated group, and more than 50 percent of MooreCo, the parent of the distributing corporation, is acquired outside of the affiliated group. Therefore, the intragroup spin-off of the SubCo stock from ABC to MooreCo is not subject to the nonrecognition rules of Code Sec. 355. The subsequent distribution of the SubCo stock to MooreCo shareholders is subject to the general recognition of gain rules discussed above.

The Conference Committee Report suggests that the IRS may consider issuing regulations under which gain would not have to be recognized when an intragroup distribution fails to qualify under Code Sec. 355. For example, in the above example instead of the recognition of gain, adjustments could be made to the basis in the stock of ABC and SubCo.

In determining whether the distribution of stock between members of an affiliated group is part of a transaction that results in a taxable acquisition, the rules discussed above under *"acquisition of a controlled corporation"* are applicable. Therefore an intragroup spin-off will not be disqualified from the nonrecognition rules of Code Sec. 355 if gain recognition would not be required under the general rule of new Code Sec. 355(e). For example, if after an intragroup spin-off the distributing corporation and the controlled corporations are members of a single affiliated group, then the nonrecognition rules of Code Sec. 355 would apply to the transaction.

Additionally, in the case of any distribution of stock of one member of an affiliated group of corporations to another member, the IRS is authorized under Code Sec. 358(c) to provide adjustments to the basis of any group member's stock to appropriately reflect the proper treatment of the distribution (Code Sec. 355(g)).

The Conference Committee Report notes its concerns with the current consolidated return regulations regarding basis adjustments resulting from a distribution. One concern is that excess loss accounts may not be recaptured when there is an internal spin-off followed by the subsidiary leaving the group. The Conference Committee Report states that the IRS may consider providing rules that require a carryover basis within the group for the stock of the distributed corporation, including a carryover of an excess loss account. Also suggested is that the change in the value and basis of the distributing corporation's assets should be reflected in basis reduction to the stock of the distributing corporation.

Another concern noted in the Conference Committee Report is that under current rules a shareholder's basis after a distribution is allocated between the stock of distributing and controlled corporations in proportion to fair market value. Thus, in certain cases, an affiliated group can benefit from a high inside basis in one corporation, increasing depreciation deductions, and a high outside basis in the other corporation that would reduce gain if that corporation was sold. Therefore, the Conference Committee Report suggests, the IRS may determine that the aggregate stock basis of distributing and controlled after the distribution should be adjusted to an amount that is less than the aggregate basis of the stock of the distributing corporation before the distribution. This would prevent the inappropriate potential for artificial losses or diminishment of gain on disposition of any of the corporations involved in a spin-off.

Also suggested in the Conference Committee Report is providing separate rules for affiliated groups filing consolidated returns and affiliated groups that do not file consolidated returns.

Control. Rules for determining control immediately after a distribution are modified for Code Sec. 351 transactions. The fact that a corporate transferor distributes part or all of the stock it receives in the exchange to its shareholders is disregarded. In a transaction that otherwise meets the requirements of Code Sec. 355, shareholders receiving stock in a distributed corporation are treated as in control of the distributed corporation immediately after the distribution if they hold stock representing greater than 50 percent of the total combined voting power and 50 percent of the value of all classes of stock of the distributed corporation (Code Sec. 351(c)).

In the case of certain divisive transactions, for purposes of determining whether it qualifies as a "D" reorganization, if the transaction otherwise qualifies under Code Sec. 354(b)(1)(A) and (B) (nonrecognition of gain or loss if substantially all the assets are transferred and the stock, securities and properties received

by the transferor are distributed under a plan of reorganization), then the control test of Code Sec. 304(c) is applicable. The control test of Code Sec. 304(c) is generally satisfied if at least 50 percent of the total combined voting power and 50 percent of the value of all classes of stock are owned, applying the attribution rules of Code Sec. 318(a) (see Code Sec. 304(c) for details). However, in a transaction that otherwise meets the requirements of Code Sec. 355, shareholders receiving stock in a distributed corporation are treated as in control of the distributed corporation immediately after the distribution if they hold stock representing greater than 50 percent of the total combined voting power and 50 percent of the value of all classes of stock of the distributed corporation with no stock attribution (Code Sec. 368(a)(2)(H)).

Extended statute of limitations. The statutory period for the assessment of any deficiency attributable to gain recognized because of the application of Code Sec. 355(e)(1) does not expire before the expiration of three years from the date the taxpayer notifies the IRS that the distribution occurred. The manner of notification may be prescribed by regulations. Such a deficiency may be assessed before the expiration of the three year period even though other provisions would otherwise prevent the assessment (Code Sec. 355(e)(4)(E)).

PRACTICAL ANALYSIS. Dan Rahill, tax partner at the Chicago office of KPMG Peat Marwick LLP, observes that this provision's enactment would affect many companies across all industries, but particularly those operating in technology-driven, rapidly changing environments. The ability to reorganize is highly desirable and necessary in today's extremely competitive global marketplace. Without this flexibility American companies will be at a disadvantage with foreign competitors not faced with the same reorganizational costs. Spin-offs are a very common part of corporate tax planning and very few Morris Trust transactions are abusive. Regrettably, this legislation is not tailored to reach only those abusive transactions.

Effective date. These provisions are generally effective for distributions after April 16, 1997, pursuant to a plan (or a series of related transactions) that involves an acquisition described in Code Sec. 355(e)(2)(A)(ii) occurring after that date. However, the greater than 50 percent control requirement immediately after certain Code Sec. 351 and Code Sec. 368(a)(1)(D) distributions will be effective for transfers after August 5, 1997.

Under transitional rules, these provisions that would otherwise require gain to be recognized to the distributing or controlled corporation do not apply to any distribution pursuant to a plan (or a series of related transactions) occurring after April 16, 1997, if such acquisition (or transfer the subject of Act Sec. 1012(c)) is:

(1) made pursuant to an agreement which was binding on April 16, 1997 and at all times thereafter;

(2) described in a ruling request submitted to the IRS on or before that date; or

(3) described on or before that date in a public announcement or in a filing with the Securities and Exchange Commission (SEC) required solely by reason of the acquisition or transfer.

The transition rules do not apply to any agreement, ruling request, or public announcement or SEC filing unless it identifies the acquirer of the distributing corporation or any controlled corporation, or the transferee, whichever is applicable. The Conference Committee Report points out that the transition rules apply to any contract, even if not written, that is binding under State law as of April 16, 1997. It is expected that some form of contemporaneous written evidence of the contract would exist.

Act Sec. 1012(a), adding Code Sec. 355(e); Act Sec. 1012(b), adding Code Secs. 355(f) and 358(g); Act Sec. 1012(c), amending Code Secs. 351(c) and 368(a)(2)(H); and Act Sec. 1012(d). Law at ¶ 5117, 5121, 5125, and 5129. Committee Report at ¶ 11,170.

Redemptions Involving Related Corporations

¶ 505

Background

If one corporation purchases stock of a related corporation, the transaction generally is recharacterized as a redemption under Code Sec. 304. Sales proceeds received by a corporate transferor that are characterized as a dividend may qualify for the dividends received deduction under Code Sec. 243. Code Sec. 1059 applies to "extraordinary dividends," including certain redemption transactions treated as dividends qualifying for the dividends received deduction. Under prior law, if a redemption resulted in an extraordinary dividend, Code Sec. 1059 generally required the shareholder to reduce its basis in the stock of the redeeming corporation by the nontaxed portion of the dividend.

Tax treatment of certain corporate stock transfers treated as redemptions reformed.—When a corporation purchases stock of a related corporation, the transaction generally is treated as a redemption under Code Sec. 304. Under the redemption rules, sales proceeds received by a corporate transferor may be treated as a dividend under Code Sec. 301 to the extent of earnings and profits (E&P) of the acquiring corporation and then to the extent of E&P of the issuing corporation. However, a corporation receiving dividends is generally entitled to a dividends received deduction under Code Sec. 243. Thus, a significant portion of the proceeds received by the related corporation may be untaxed.

Generally, 50 percent ownership is sufficient control for purposes of qualification as a related corporation under Code Sec. 304(c)(1). Further, when applying the constructive ownership rules of Code Sec. 318, five percent is substituted for 50 percent. The result of the constructive ownership rules is that a corporation need not directly own any stock of another corporation to be related for these purposes.

Under the amended rules, to the extent that a Code Sec. 304 transaction is treated as a distribution under Code Sec. 301, the transferor and the acquiring corporation are treated as if:

(1) the transferor had transferred the stock involved in the transaction to the acquiring corporation in exchange for stock of the acquiring corporation in a transaction to which Code Sec. 351(a) applies (a nontaxable contribution to capital); and

(2) the acquiring corporation had then redeemed the stock it is treated as having issued.

The purpose of this two-step rule is to treat the acquiring corporation as having redeemed the stock, and the stock is treated as having been issued to the transferor.

Extraordinary dividend. A dividend is considered extraordinary when it exceeds, generally, 10 percent of a corporation's basis in a share of stock (five percent for preferred dividends) (see Code Sec. 1059). A redemption considered an extraordinary dividend that qualifies for the dividends received deduction requires the shareholder to reduce its basis in the stock of the redeeming corporation by the nontaxed portion of the dividend (e.g., the portion of the dividend to which the dividends received deduction applies). Under the new provisions, if a Code Sec. 304 transaction is treated as a dividend to which the dividends received deduction applies, the dividend is treated as an extraordinary dividend in which *only* the basis of the transferred shares is taken into account.

Example. Holding Corporation owns 75% of the shares of SubCo1 and all the shares of Beta. SubCo1 owns all 10 of the issued shares of SubCo2 with a basis of $75. Beta has sufficient earnings and profits so that any distribution of property would be treated as a dividend. SubCo1 sells all but one of its shares in SubCo2 to Beta for $90, the fair market value. SubCo1, the transferor, is treated as having transferred the SubCo2 stock to Beta, the acquiring corporation, in exchange for the stock of Beta in a deemed Code Sec. 351(a) transaction. Beta is then treated as having redeemed the stock it was deemed as having issued to SubCo1. Assume $63 of the dividend (70% of the $90 distribution) is untaxed because of the dividends received deduction under Code Sec. 243. Because basis in the transferred shares must be reduced under Code Sec. 1059 for the non-taxed portion of the deemed dividend payment, there is a reduction in SubCo1's $75 basis in the remaining share it holds in SubCo2 to $12 ($75 − $63).

Foreign corporations. The E&P of an acquiring foreign corporation that are taken into account for purposes of applying Code Sec. 304 can not exceed the portion of the E&P that:

(1) is attributable to stock of the acquiring corporation held by a corporation or individual who is the transferor (or a related person) and who is a U.S. shareholder (within the meaning of Code Sec. 951(b)), and

(2) was accumulated during periods in which the stock was owned by that person while the acquiring corporation was a controlled foreign corporation.

For purposes of this rule (except as otherwise provided by regulations), the rules of Code Sec. 1248(d), relating to certain exclusions from E&P, apply. The IRS is to prescribe regulations as appropriate, including, according to the Conference Committee Report, regulations to determine the earnings allocable to particular stock of the acquiring corporation.

Effective date. These provisions are effective for distributions or acquisitions after June 8, 1997. However, the provisions will not apply to any distribution or acquisition (1) made pursuant to a written agreement which was binding on June 8, 1997, and at all times thereafter, (2) described in a ruling request submitted to the IRS on or before date, or (3) described in a public announcement or filing with the Securities and Exchange Commission on or before that date.

Act Sec. 1013(a), amending Code Sec. 304(a)(1); Act Sec. 1013(b), amending Code Sec. 1059(e)(1)(A)(iii) (as amended by Act Sec. 1011(b));

Act Sec. 1013(c), adding Code Sec. 304(b)(5); and Act Sec. 1013(d). Law at ¶ 5111 and 5337. Committee Report at ¶ 11,175.

Preferred Stock Treated as Boot

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Background

Gain or loss is generally not recognized in Code Sec. 368 reorganization transactions except to the extent that other property ("boot") is received in the transaction. Since boot is property other than certain stock, under prior law preferred stock could be received tax-free in a reorganization. Debt securities can be received tax-free in such a transaction but only to the extent that debt securities of an equal amount are surrendered in the exchange. Thus, although many preferred stocks are functionally equivalent to debt securities, the distribution of preferred stock presented tax advantages. Other than this debt-for-debt rule, similar rules generally applied to Code Sec. 351— nontaxable property contributions to a corporation by members of a group controlling 80 percent of the corporation. Further, under Code Sec. 1036 no gain or loss was recognized when common stock of a corporation was exchanged solely for preferred stock in the same corporation.

Certain preferred stock treated as boot.—In a Code Sec. 368 reorganization transaction, a Code Sec. 351 transfer to a controlled corporation, or a Code Sec. 355 distribution from a controlled corporation, gain or loss is generally recognized only if "other property," property other than stock, is received. Subject to certain exceptions, the new amendments treat "nonqualified preferred stock" as boot for purposes of Code Secs. 351, 354, 355, 356, and 368. Similarly, when nonqualified preferred stock is received in exchange for common stock of the same corporation, the nonrecognition rules of Code Sec. 1036 do not apply to the extent of the nonqualified preferred stock received.

Thus, when a taxpayer exchanges property for nonqualified preferred stock in a transaction that qualifies under Code Sec. 351, 355, or 368, gain, but not loss, would be recognized.

> **Example.** Allan Founder contributes property to a controlled corporation in a transaction described in Code Sec. 351. The property has a basis of $30,000 and a fair market value of $100,000. In exchange, Founder receives nonqualified preferred stock valued at $50,000, common stock worth $45,000, and $5,000 cash. Founder has a realized gain of $70,000 ($100,000 of total consideration received ($50,000 + $45,000 + $5,000) less $30,000 basis). However, under Code Sec. 351(b), this gain is only recognized to the extent of $55,000 (the total of the cash, $5,000, and other property, $50,000 of nonqualified preferred stock, received in the transfer).

An exchange of nonqualified preferred stock for nonqualified preferred stock in an acquiring corporation may qualify for tax-free treatment under Code Sec. 354, but not Code Sec. 351. According to the House Committee Report, in cases in which both Code Secs. 354 and 351 may apply to a transaction, Code Sec. 354 is generally applicable. Thus, in that situation, the exchange of nonqualified preferred stock for other nonqualified preferred stock is tax-free.

Definition of stock in a Code Sec. 351 transfer. To qualify for nonrecognition under Code Sec. 351, property must be transferred to a corporation solely in

exchange for stock by one or more persons who are in control of the corporation (control is defined in Code Sec. 368(c)). The Conference Committee Report clarifies that, although nonqualified preferred stock may be treated as boot, nonqualified preferred stock is considered stock for purposes of qualifying for nonrecognition under Code Sec. 351(a), unless and until regulations provide otherwise. Thus, if an individual transfers appreciated property to a corporation in exchange for both common stock and nonqualified preferred stock, he will only recognize gain to the extent of the fair market value of the nonqualified preferred stock received in the transaction. The Code Sec. 351 nonrecognition rules are applicable to the property transferred to the corporation for stock other than nonqualified preferred stock.

Similarly, for purposes of determining whether the transferors in an otherwise qualifying Code Sec. 351 transfer are in control of the corporation, the stock ownership of an individual who transfers property and only receives nonqualified preferred stock would, presumably, be considered in determining whether the persons making the transfer are in control. The Conference Committee Report notes that future regulations may change this result.

Preferred stock is defined as stock that is limited and preferred as to dividends and does not participate in corporate growth to any significant extent. These amendments, which treat preferred stock as boot, only apply to *nonqualified preferred stock* which is defined as preferred stock for which:

(1) the holder has the right to require the issuer or a related person (within the meaning of Code Sec. 267(b) or 707(b)) to redeem or purchase the stock;

(2) the issuer or a related person is required to redeem or purchase the stock;

(3) the issuer or a related person has the right to redeem or purchase the stock and, as of the issue date, it is more likely than not that such right will be exercised; or

(4) the dividend rate on the stock varies in whole or in part (directly or indirectly) with reference to interest rates, commodity prices, or other similar indices. According to the House Committee Report, such stock with a varying dividend rate is treated as nonqualified preferred stock regardless of whether such varying rate is provided as an express term of the stock (for example, an adjustable rate stock) or as a practical result of other aspects of the stock (for example, auction rate stock).

The rules of (1), (2), and (3), above, for nonqualified preferred stock, do not apply if the right or obligation referred to:

(1) cannot be exercised within 20 years of the date the right or obligation is issued and is subject to a contingency which, as of the issue date, makes the likelihood of the redemption or purchase remote;

(2) may be exercised only upon the death, disability, or mental incompetency of the holder (however this exception is not applicable if any class of the stock surrendered or the stock received in the exchange is publicly traded, or of a related corporation, or if the exchange is part of a transaction or series of transactions by which a corporation is to become publicly traded); or

(3) in the case of a right or obligation to redeem or purchase stock transferred in connection with the performance of services for the issuer or a

related person, it may be exercised only upon the holder's separation from service.

The Conference Committee Report clarifies that a conversion privilege into the stock of the issuer does not automatically constitute a right to participate in corporate growth to a significant extent. Thus, the inclusion of a conversion privilege to stock which would otherwise be treated as nonqualified preferred stock does not automatically avoid that characterization. Further, the Conference Committee Report clarifies that stock convertible or exchangeable into stock of a corporation other than the issuer, such as the issuer's parent or other related corporation, is not considered participation in corporate growth to a significant extent.

Recapitalizations of family-owned corporations. Excluded from gain recognition under the rules which treat preferred stock as boot are exchanges of stock in certain recapitalizations of family-owned corporations. For this purpose, a family-owned corporation is defined in Code Sec. 447(d)(2)(C)(i) as any corporation if at least 50 percent of the total combined voting power of all classes of stock entitled to vote and at least 50 percent of all other classes of stock of the corporations are owned by members of the same family for five years preceding the recapitalization and for three years following the recapitalization. Members of the same family are defined by reference to Code Sec. 447(e) and include an individual, the individual's siblings (by the whole and half-blood and by legal adoption), aunts and uncles, great-aunts and great-uncles, and the ancestors, lineal descendants, spouse, and estate of any of the preceding individuals. Special stock attribution rules are applied. However, stock is not treated as owned by a family member during any period in which the holder of the stock has substantially diminished his risk of loss with respect to the stock through an option, short sale, any special class of stock, or any other device or transaction.

Regulations. The IRS is authorized to issue regulations to carry out the purposes of these rules. According to the House Committee Report, the IRS may apply installment sale-type rules to preferred stock that is subject to these amendments and also to prescribe treatment of preferred stock subject to these provisions under other sections of the Code (e.g., Code Secs. 304, 306, 318, and 368(c)). However, until regulations are issued, preferred stock which is subject to these amendments will continue to be treated as stock under other Code provisions.

PRACTICAL ANALYSIS. Mark Luscombe, Principal Analyst for the Federal and State Tax Group at CCH INCORPORATED, notes that this provision originally arose as one of the Administration's provisions to close what were perceived to be corporate tax loopholes. This provision tends to reclassify preferred stock as boot in acquisition and reorganization contexts in a manner similar to the treatment of preferred stock in distributions under Code Sec. 305. Such disqualified preferred stock generally has characteristics that make it appear the stock was not designed to participate in corporate growth to any significant extent. The 20-year safe harbor may be of more value than at first appears since often in an acquisition or reorganization the preferred stockholder has the intent to hold the stock until death in order to qualify for basis step up.

Effective date. The amendments are generally effective for transactions after June 8, 1997. However, they do not apply to transactions after that date that are (1) subject to a written agreement binding on June 8, 1997, and at all times thereafter, (2) described in a ruling request submitted to the IRS on or before that date, or (3) described in a public announcement or a Securities and Exchange Commission filing on or before that date.

Act Sec. 1014(a), redesignating Code Sec. 351(g) as (h) and adding a new Code Sec. 351(g); Act Sec. 1014(b), adding Code Sec. 354(a)(2)(C); Act Sec. 1014(c), adding Code Sec. 355(a)(3)(D); Act Sec. 1014(d), redesignating Code Sec. 356(e) and (f) as (f) and (g), respectively, and adding a new Code Sec. 356(e); Act Sec. 1014(e), amending Code Sec. 354(a)(2)(B) and (3)(A), and Code Sec. 355(a)(3)(C) and (4)(A), and redesignating Code Sec. 1036(b) as (c) and adding a new Code Sec. 1036(b); Act Sec. 1014(f). Law at ¶ 5117, 5119, 5121, 5123, and 5327. Committee Report at ¶ 11,180.

Investment Company Definition Under Code Sec. 351

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Background

Gain or loss is generally not recognized by a contribution of property by members of a group controlling 80 percent of a corporation or by a partner to a partnership. However, gain or loss is recognized upon a contribution by a shareholder to a corporation that is an investment company (Code Sec. 351(e)(1)), and gain, but not loss, is recognized upon a contribution by a partner to a partnership that would be treated as an investment company if the partnership were a corporation (Code Sec. 721(b)). Regulations provided that a contribution of property by a shareholder to a corporation, or by a partner to a partnership, was treated as a transfer to an investment company only if the contribution resulted, directly or indirectly, in a diversification of the transferor's interests; and the transferee was either a regulated investment company (RIC), a real estate investment trust (REIT), or a corporation more than 80 percent of the assets of which by value (excluding cash and non-convertible debt instruments) were readily marketable stocks or securities or interests in RICs or REITs that were held for investment (Reg. § 1.351-1(c)(1)). Under prior law, a partnership or a corporation might not have been treated as an investment company even though more than 80 percent of its assets were a combination of readily marketable stock and securities and other high-quality investment assets of determinable values. The Act's provisions are particularly aimed at so-called swap funds—partnerships or RICs structured to allow tax-free contributions of stock and securities in exchange for an interest in the fund holding similar interests.

Scope of investment company assets increased for purposes of Code Sec. 351.—The definition of an investment company is modified for purposes of determining whether a transfer of property to a partnership or corporation results in gain recognition (under Code Sec. 351(e) and Code Sec. 721(b)) by expanding the types of assets that are taken into account for purposes of the definition. Generally, a contribution of property to a corporation does not result in gain or loss to the contributing shareholder provided that the contributor is part of a group of contributors who own 80 percent of the voting stock of each class of stock entitled to vote. Similarly, a contribution of property to a partnership generally does not result in recognition of gain or loss to the contributing partner. However, gain or loss is recognized upon a contribution by a shareholder to a corporation that is

considered an *investment company* (Code Sec. 351(e)(1)). Gain, but not loss, is recognized upon a contribution by a partner to a partnership that would be treated as an investment company if the partnership were a corporation (Code Sec. 721(b)).

The Act provides an expanded definition of what constitutes "property" transferred to an investment company. Reading the existing regulations together with the new provisions, the definition of an investment company includes any corporation or partnership if more than 80 percent of the value of its assets consists of: money; stocks and other equity interests in a corporation; evidences of indebtedness, options, forward or futures contracts, notional principal contracts and derivatives; foreign currency; interests in precious metals (unless used in an active trade or business after the contribution); interests in a regulated investment company (RIC) or a real estate investment trust (REIT), common trust funds, and publicly-traded partnerships (as defined in Code Sec. 7704(b)); or other interests in noncorporate entities that are convertible into or exchangeable for any of the listed assets. Other assets that count toward the 80-percent test are interests in an entity if substantially all of the assets of the entity are listed assets, and to the extent provided in regulations, interests in other entities, but only to the extent of the value of the interest that is attributable to listed assets.

The IRS is granted regulatory authority to add other assets to the list in the provision, or, under certain circumstances, to remove items from the list.

PRACTICAL ANALYSIS. Chuck Levun of Levun, Goodman & Cohen, Northbrook, Illinois, points out that, pursuant to Code Secs. 351(e) and 721(b) and the regulations thereunder, a contribution of appreciated property to a corporation or partnership that is considered to be an investment company is a taxable transaction. Under prior law, a corporation or partnership was an investment company if more than 80 percent of its assets consisted of marketable stock or securities. The Taxpayer Relief Act of 1997 amends Code Sec. 351(e) (and, by reference, Code Sec. 721(b)) to include, among other assets, stock and securities (whether or not marketable) and cash, as tainted assets.

Whereas, it appears that it was Congress's intention to preclude the tax-free contribution of marketable securities into a corporation or partnership (subject to certain exceptions contained in the regulations), where non-marketable securities were added to the asset mix to bring the marketable portion below the 80-percent threshold, the breadth of this legislative change could be more sweeping than one might suspect. For instance, it appears that a contribution of real estate (a non-tainted asset) to a partnership, along with a major infusion of cash (i.e., over 80 percent of the partnership's total value) could constitute the creation of an investment company, because cash is now a tainted asset. One should note, however, that there is a legislative history that might suggest that if it can be shown that the cash is to be used to enhance the non-tainted real estate, the partnership will not be treated as an investment company.

The Senate Committee Report states that the new provision is intended to change only the types of assets considered in the definition of an investment

company in Reg. § 1.351-1(c)(1)(ii), and not to override other provisions of those regulations. For example, the Report states that the new provision does not override:

(1) the requirement that only assets held for investment are considered for purposes of the definition (Reg. § 1.351-1(c)(3));

(2) the rule treating the assets of a subsidiary as owned proportionally by a parent owning 50 percent or more of its stock (Reg. § 1.351-1(c)(4));

(3) the requirement that the investment company determination consider any plan with regard to an entity's assets in existence immediately after the transfer (Reg. § 1.351-1(c)(2)); and

(4) the requirement that a contribution of property to an investment company result directly or indirectly in diversification in order for gain to be recognized (Reg. § 1.351-1(c)(1)(i)).

The Senate Committee Report states that although cash is counted in the 80-percent test in the new provision, Reg. § 1.351-1(c)(2) (discussed in (3), above) should be applied so that if, as part of a plan, cash is used to purchase assets that are not treated as stock or securities, then the investment company determination is made after the asset purchase.

Example (1). Joe Tinker and John Evers each own 50% of Chance Corporation and are in control for purposes of Code Sec. 351. On December 1, 1997, Chance has $10,000 of total assets consisting of $2,500 of operating assets, $4,000 of stock options, and $3,500 of precious metal futures contracts. On that date, solely in exchange for Chance stock, Tinker contributes $5,000 cash and Evers contributes an interest in the TEC partnership valued at $5,000. TEC's assets consist entirely of marketable securities. In determining whether Chance is an investment company, the $4,000 of stock options, $3,500 of precious metal futures contracts, $5,000 cash, and the $5,000 partnership interest are all considered listed assets. Thus, 87.5% ($17,500 ÷ $20,000) of Chance's assets are listed assets, and Chance is an investment company. Evers must recognize gain, if any, on the exchange of the partnership interest for Chance stock.

Example (2). The same facts as in Example (1), above, except that Chance Corporation has a plan in effect on December 1, 1997, to purchase $5,000 of operating assets, and the cash contributed by Tinker is in fact used to purchase operating assets. The plan to purchase nonlisted assets is taken into account in making the investment company determination (under Reg. § 1.351-1(c)(2)). Therefore the cash will not be treated as a listed asset and 62.5% ($12,500 ÷ $20,000) of Chance's assets are listed assets. Since this is less than 80%, Chance is not considered an investment company, and Evers will not recognize any gain on the exchange of the partnership interest under the general rule of Code Sec. 351.

PRACTICAL ANALYSIS. Steven Surdell of Jenner & Block, Chicago, Ill., points out that the principal impact of modified Code Sec. 351(e) appears to be on so-called exchange or swap funds. These funds, which are generally partnerships for tax purposes, are designed to provide holders of appreciated financial assets with tax-free risk diversification. Essentially, the fund identifies taxpayers holding appreciated financial assets (such as stock) and

then allows the holders to contribute qualifying stock to the partnership. Because numerous taxpayers holding different appreciated stocks will contribute to the partnership, contributors will achieve diversification by converting a single appreciated stock position into a partnership interest in a partnership holding a diversified portfolio.

Under the general nonrecognition rules of Code Sec. 721, the contribution of appreciated property to a partnership is tax free. Code Sec. 721(b) provides an exception to this nonrecognition rule, however, if the partnership is an investment company as defined under Code Sec. 351(e). As previously drafted, Code Sec. 351(e) itself provided little guidance on what constituted an investment company, but the Treasury regulations generally provided that a corporation was an investment company if more than 80 percent of its assets were invested in marketable securities. In order to obviate this problem, exchange funds typically borrowed 20 percent of their value and invested in nonpublicly traded fixed-income assets. By amending Code Sec. 351(e) to include debt in the definition of securities, the Act seems to limit the ability to circumvent Code Sec. 351(e) by investing in nonpublicly traded debt.

Effective date. The provision applies to all transfers after June 8, 1997, in tax years ending after that date. An exception is provided for transfers of a fixed amount of property made pursuant to a binding written contract in effect on June 8, 1997, and at all times thereafter before the transfer.

Act Sec. 1002(a), amending Code Sec. 351(e)(1); and Act Sec. 1002(b). Law at ¶ 5117. Committee Report at ¶ 11,125.

INTEREST DEDUCTIONS

Interest Paid on Disqualified Debt Instruments

¶ 513

Background

The determination of whether an instrument is debt or equity is made under all facts and circumstances based on principles of developed case law. The issuer receives a deduction for interest when the instrument is debt, but does not receive a deduction when the instrument is equity. Prior to the Taxpayer Relief Act of 1997, corporations have attempted to claim interest deductions with respect to issuances of debt that are payable with the issuer's stock or convertible to the issuer's stock.

No interest deduction for "payable in equity" debt.—No deduction is allowed for any interest paid or accrued on a "disqualified debt instrument." The term "disqualified debt instrument" means any indebtedness of a corporation that is payable in equity of the issuer or a related party within the meaning of Code Sec. 267(b) or Code Sec. 707(b).

"Payable in equity." Debt is treated as payable in equity of the issuer or a related party if (1) a substantial portion of the principal or interest is required to

be paid or converted, or at the issuer's or related party's option is payable in, or converted into, equity of the issuer or a related party; (2) a substantial portion of the principal or interest is required to be determined, or may be determined at the option of the issuer or related party, by reference to the value of equity of the issuer or related party; or (3) the debt is part of an arrangement designed to result in payment of the instrument with or by reference to the equity. This type of arrangement could include the issuance of a forward contract in connection with the issuance of debt, nonrecourse debt that is secured principally by the stock, or debt instruments that are convertible at the holder's option when it is substantially certain that the right will be exercised. Under the Conference Committee Report, it is not expected that this provision will affect debt with a conversion feature where the conversion price is significantly higher than the market price of the stock on the date of the debt issuance.

PRACTICAL ANALYSIS. Steven Surdell of Jenner & Block, Chicago, Ill., notes that, like new Code Sec. 1259, the modification of Code Sec. 163 descends directly from the various so-called Pearl Harbor Day proposals first advanced by the Clinton Administration on December 7, 1995. The modification reflects Congress' concern with certain hybrid debt instruments which combine aspects of both stock and debt and appears to be aimed at certain PRIDES®-type transactions in which the issuer's debt is repaid in the stock of the issuer (or a 50% affiliate) or is cash settled by reference to the value of such stock—but only if it is substantially certain that the debt will be repaid in (or cash settled by reference to) such stock. Because the "tainted" stock must be that of a 50% affiliate, the provision would generally not apply to DECS®-type transactions because those transactions generally do not involve 50% or greater affiliates. In these latter transactions, a corporation which owns appreciated portfolio stock in a second corporation issues debt which is payable by reference to the value of the portfolio stock. For example, if the portfolio stock is worth $100 per share on the date of the debt issuance, each DECS® will be issued for a face amount of $100. On the DECS® maturity date (typically three years after issuance) if the shares are worth less than $100, the issuer may settle its debt obligation by delivering one share of the stock (typically the issuer is also allowed to cash settle rather than settling by physical delivery of the shares) so that the DECS® holder has downside risk on the portfolio stock. If the stock appreciates by up to 20 percent, the issuer typically retains all of the appreciation, and if the appreciation exceeds 20 percent, the issuer and the holders share the appreciation pursuant to a predetermined formula.

New Code Sec. 163(l) would deny an interest deduction to a "disqualified debt instrument," which is essentially defined, as described above, as debt repayable in the stock of the issuer (or a 50% affiliate) or cash settled by reference to the value of such stock. Thus the provision may have applicability to certain debt issuances which couple debt with a forward on the issuer's stock, but only if the transaction is substantially certain to result in the repayment of the debt with the issuer's stock (or be cash settled by reference to such stock). In those circumstances in which the

provisions do apply, they are fairly draconian, since the issuer is denied an interest deduction but a corporate holder is denied a dividends-received deduction. The provision thus has the effect of treating the parties asymmetrically, since the issuer is essentially treated as if it issued equity and the holder is essentially treated as if it held debt.

Significantly, the Clinton Administration proposals would have included certain long-term debt in the definition of "disqualified debt instruments." For these purposes, the long-term debt was generally defined as debt with a weighted average maturity of more than 40 years. This long-term debt proposal is not included in the Act.

Effective date. The provision applies to disqualified debt instruments issued after June 8, 1997, unless the instrument is (1) issued pursuant to a written agreement that was binding on June 8, 1997, and at all times thereafter, (2) described in a ruling request submitted to the IRS on or before June 8, 1997, or (3) described on or before June 8, 1997, in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the issuance.

Act Sec. 1005(a), amending Code Sec. 163 by redesignating subsection (l) as subsection (m) and adding new subsection (l); Act Sec. 1005(b). Law at ¶ 5069. Committee Report at ¶ 11,140.

OTHER DEDUCTIONS AND LOSSES

Dividends Received Deduction

¶ 517

Background

Under prior law, the dividends received deduction was allowed to a corporate shareholder if the corporation satisfied a 46-day holding period for the dividend-paying stock. A 91-day holding period was required for dividends on preferred stock if the dividend was attributable to a period or periods aggregating in excess of 366 days. However, also under prior law, there was no requirement that the dividend-paying stock be held for the period immediately before or immediately after the time that the taxpayer became entitled to the dividend.

Holding period for dividends received deduction modified.—A corporation is not entitled to a dividends received deduction if the dividend paying stock is held less than 46 days during the 90-day period that begins 45 days before the stock becomes ex-dividend with respect to the dividend. The holding period for dividends on preferred stock attributable to a period or periods in excess of 366 days is increased to 91 days during the 180-day period that begins 90 days before the stock becomes ex-dividend with respect to the dividend.

Example. XYZ Corporation purchases ABC Corporation stock on September 30, 1997, and receives a dividend from ABC on November 1, 1997. The ex-dividend date for the dividend is October 1, 1997. XYZ sells the ABC stock on December 20, 1997. In order to satisfy the holding period for receiving a dividends received deduction, XYZ must have held the stock for at least 46 days during the 90-day period beginning on August 17 (which is 45

days prior to the October 1 ex-dividend date) and ending on November 14 (which is the 90th day of the period). In this case, the date of acquisition is disregarded, but the date of disposition is taken into account (under Code Sec. 246(c)(3)(A)). XYZ held the stock during the period from October 1 (the day after the purchase of ABC stock) through November 14. This period equals 45 days and fails to satisfy the 46-day holding period requirement.

Effective date. The provision is effective for dividends paid or accrued after the 30th day after August 5, 1997 (September 5, 1997).

Under transitional relief, these provisions do not apply to dividends received or accrued during the two-year period beginning on August 5, 1997 provided that:

(1) the dividend is paid with respect to stock held by the taxpayer on June 8, 1997, and at all times until the dividend is received;

(2) the stock is continuously subject to a position (e.g., option) that reduces the risk of loss (under Code Sec. 246(c)(4)) until the dividend is received; and

(3) the stock and position are clearly identified in the taxpayer's records within 30 days after August 5, 1997 (September 5, 1997).

Transitional relief is not available if the position is sold, closed, or otherwise terminated and reestablished.

Act Sec. 1015(a), amending Code Sec. 246(c)(1)(A); Act Sec. 1015(b), amending Code Sec. 246(c)(2) and (3), striking Code Sec. 246(c)(3)(B) and redesignating Code Sec. 246(c)(3)(C) as (c)(3)(B); Act Sec. 1015(c). Law at ¶ 5093. Committee Report at ¶ 11,185.

Charitable Contributions of Computers

¶ 519

Background

Although an itemized deduction is generally allowed for the fair market value of property contributed to a charitable organization, the deduction for a contribution of inventory or other ordinary-income property, short-term capital gain property, or certain gifts to private foundations has been limited to the taxpayer's basis in the property. Similarly, if tangible personal property was given to a charitable organization and the use by the recipient charitable organization was unrelated to the organization's tax-exempt purpose, the charitable deduction has been limited to the adjusted basis in the property. Augmented deductions have been available for certain contributions by C corporations, but under prior law, these augmented deductions were limited to contributions of inventory property for the care of the ill, the needy, infants, and for certain contributions of scientific equipment constructed by the taxpayer, provided the original use of such donated equipment was by the recipient and used for research or research training in the U.S. in physical or biological sciences.

Increased charitable contribution deduction for gifts of computers by C corporations.—The list of contributions that qualify for the "augmented charitable deduction" has been expanded to include certain gifts to schools of computer technology and equipment. Qualification for the augmented charitable deduction permits the grantor a greater deduction when contributing inventory or other ordinary income property. The deduction previously was limited to the basis of the

donated property for such gifts. These new rules are only applicable to gifts by C corporations.

The amount of the augmented deduction is equal to the donor's or the taxpayer's basis in the donated property plus one-half of the amount of ordinary income that would have been realized if the property had been sold. However, the augmented deduction can not exceed twice the basis of the donated property.

Qualified gifts of computer technology and equipment include contributions of computer software, computer or peripheral equipment, and fiber optic cable related to computer use that are to be used within the U.S. for educational purposes in any grade K through 12. The donated property must fit productively into the educational plans of the school.

An eligible donee for these purposes is:

(1) an educational organization that normally maintains a regular faculty and curriculum and has a regularly enrolled body of pupils in attendance at the place where its educational activities are regularly conducted;

(2) A Code Sec. 501(c)(3) entity that is organized primarily for purposes of supporting elementary and secondary education; and

(3) a private foundation that within 30 days after receipt of the contribution contributes the property to an eligible donee described in (1) and (2) above and notifies the donor of the contribution.

Qualified contributions are limited to gifts made no later than two years after the date the taxpayer acquired or substantially completed the construction of the donated property. The original use of the property must be by the donor or the donee. The donee may not transfer the donated property for money, services, or other property, except for shipping, transfer, and installation costs. Only donations made by C corporations can qualify for the enhanced credit; S corporations, personal holding companies, and service organizations cannot be eligible donors.

Example. On January 2, 1998, a C corporation, Flotsam Inc., donates computer equipment, which it purchased new on or after February 1, 1996, to a public high school in the United States. At the time of the contribution, the equipment has a fair market value of $100,000 and an adjusted basis of $30,000. The contribution of eligible property that is less than two years old to a qualified donee qualifies for an enhanced charitable deduction, which is calculated under Code Sec. 170(e)(3) as follows. To the donor's basis, $30,000, is added one-half of the gain that would have been realized if the property had been sold at its fair market value, $35,000 ($100,000 − $30,000 ÷ 2), for a total of $65,000 ($30,000 + $35,000). However, since this amount exceeds twice the donor's basis in the contributed property, $60,000 ($30,000 × 2), the enhanced charitable deduction is limited to $60,000.

Sunset of provision. These augmented charitable deduction rules terminate for contributions made during any tax year beginning after December 31, 1999.

Effective date. These provisions are effective for tax years beginning after December 31, 1997.

Act Sec. 224, adding Code Sec. 170(e)(6). Law at ¶ 5077. Committee Report at ¶ 10,230.

Definition of Related Person

¶ 521

Background

Code Sec. 267 disallows tax losses when a sale or exchange of property takes place between certain related parties. Losses on sales or exchanges between members of the same corporate group may be deferred, rather than denied (Code Sec. 267(f)). This deferral continues until the property is transferred outside the controlled group. Many Internal Revenue Code provisions incorporate the relationships described in Code Sec. 267, where a loss is disallowed, to define "related parties."

Related parties determined by reference to Code Sec. 267(f).—Any Internal Revenue Code of 1986 provision that refers to a relationship that would result in a Code Sec. 267 loss disallowance also refers to relationships where loss is deferred under Code Sec. 267(f) (relating to losses between members of the same corporate group).

Effective date. The provision generally applies to transactions for tax years beginning after December 31, 1983.

Act Sec. 1604(e)(1), adding Code Sec. 267(f)(4); Act Sec. 1604(e)(2). Law at ¶ 5101. Committee Report at ¶ 13,950.

ALTERNATIVE MINIMUM TAX

Exemption for Small Corporations

¶ 525

Background

Under prior law, a corporation could be subject to the alternative minimum tax (AMT) no matter the amount of its gross receipts.

AMT repealed for small corporations.—A corporation that meets certain gross receipts tests is considered to be a "small corporation" and, as a result, will not be liable for the alternative minimum tax (AMT) for so long as it remains a small corporation. In addition, the allowable AMT credit has been modified for these small corporations.

Small corporation defined. For these purposes, a corporation initially qualifies as a "small corporation" if it had average gross receipts of $5,000,000 or less for the three tax years that ended with its first tax year beginning after December 31, 1996.

> **Example (1).** Binnacle Inc. had average gross receipts of $4,750,000 for the three-year period that includes its 1995, 1996 and 1997 tax years. For AMT purposes, Binnacle is considered to be a small corporation for its 1998 tax year.

Once a corporation is recognized as a small corporation, it will continue to be exempt from the AMT for so long as its average gross receipts for the prior three-year period does not exceed $7,500,000. In determining if a corporation meets this requirement, the first year that it achieved small corporation status is not taken into consideration.

Example (2). In 2002, Binnacle, which was classified as a small corporation for its 1998 tax year, determines that its average gross receipts were $7,000,000 for the three-year period that includes its 1999, 2000, and 2001 tax years. Based upon these facts, Binnacle would still be classified as a small corporation and exempt from AMT for 2002.

Planning Note. If the corporation was not in existence for the entire three-year period, Code Sec. 448(c)(3) provides that the $5,000,000 test will be applied on the basis of the period during which the corporation was in existence.

PRACTICAL ANALYSIS. Joel Miller, Esq., Flushing, N.Y., observes that, for a corporation that wishes to qualify for AMT exemption, there is one tax year that is of overwhelming importance. That is the corporation's first tax year beginning after 1996 (which would be the first tax year of a new corporation and the first tax year beginning in 1997 for an existing corporation). If a corporation cannot pass the $5 million average gross receipts test for that tax year (the basic "qualification year") it will never qualify for the exemption. On the other hand, if a corporation passed the $5 million gross receipts test for the basic qualification year, the $7.5 million rule will allow it to have considerable growth without losing qualification. For example, a new corporation with gross receipts of $5 million in 1998, $10 million in 1999, and $7.5 million in 2000 would qualify (even though a corporation with $5,000,001, $4 million, and $3 million would not because its first tax year beginning after 1996 would fail the $5 million test).

Clearly, thought should be given to deferring receipts until after the basic qualification year if that would enable a corporation to pass the $5 million gross receipts test for that year. Consider, for example, a calendar-year corporation formed in January 1999 that expects $6 million of gross receipts every year. If the corporation can defer $1 million from the end of 1999 to the beginning of 2000, it will qualify in every year that its receipts remain at the $6 million level or lower. If the corporation's business is seasonal and $2 million will be received in November and December, an alternative would be for the corporation to adopt an October 31 tax year. Code Sec. 448(c)(3)(B) would require annualization (so that the gross receipts would be deemed to be $4.8 million for the basic qualification year), but that would be good enough. The same techniques might also be used by an existing corporation, perhaps utilizing Reg. § 1.442-1(c) to create a short tax year as to which the corporation would pass the test. Also, looking further down the road, a corporation that has passed the test for the basic qualification year might similarly wish to defer receipts or have a short year in order to avoid the permanent disqualification that would result from exceeding the average-of-$7.5-million limit.

Loss of "small corporation" status. When a corporation loses its small corporation status because its average gross receipts for the prior three tax years exceed $7,500,000, it will then become liable for the AMT. However, its AMT liability will only be based upon certain preferences and adjustments that pertain to transac-

tions and investments that were entered into after the corporation lost its status as a small corporation.

> **Example (3).** In 2004, Binnacle Inc. determines that its average gross receipts for the three-year period that includes its 2001, 2002, and 2003 tax years, was $8,000,000. As a result, Binnacle must determine if it has an AMT liability for its 2004 tax year. However, it will base its AMT liability only on those transactions and investments that were entered into after the start of its 2004 tax year. It does not have to compute its AMT liability on preferences or adjustments that pertain to transactions and investments that were entered into in prior tax years.

Modifications in AMT determination. A corporation that no longer has the status of a small corporation must determine its AMT liability by making certain modifications for transaction and investments that arose "on or after the change date." The term "change date" is defined as the first day of the first tax year for which the corporation ceased to be a small corporation.The formerly small corporation is subject to the following modifications to the generally applicable AMT rules:

(1) the depreciation and pollution control preferences apply only to property placed in service on or after the change date;

(2) the mining exploration and development cost preference applies only to costs paid or incurred on or after the change date;

(3) the long-term contract preference applies only to contracts entered into on or after the change date;

(4) the AMT net operating loss deduction applies as if, in Code Sec. 56(d)(2), the change date were substituted for "January 1, 1987" each place it appears and the day before the change date were substituted for "December 31, 1986" each place it appears;

(5) the limitation on the allowance of negative adjustments based on prior adjusted current earnings (ACE) when determining the corporate ACE adjustment applies only to prior tax years beginning on or after the change date;

(6) there is *no* depreciation ACE adjustment; and

(7) the ACE earnings and profits (ACE E&P) adjustment and ACE depletion adjustment of Code Sec. 56(g)(4)(D) and (F) apply as if the day before the change date were substituted for "December 1, 1989".

Planning Note. These modifications to the computation of AMT do not apply to any item acquired in certain corporate acquisitions (e.g., a Code Sec. 381 transaction), or to any "substituted basis property" (the basis of which in the hands of the corporation is determined by reference to the basis of the property in the hands of the transferor) if such item or property was subject to any of the seven AMT adjustment modifications listed above while held by the transferor.

AMT credit for small corporations. As a general rule, taxpayers may be eligible to claim a tax credit based upon their AMT liability for the prior tax year. The computation of the allowable AMT credit is modified for a "small corporation." The small corporation's allowable AMT credit, as computed under Code Sec. 53(c)(1), is limited to the amount by which the corporation's regular tax liability (reduced by other credits) exceeds 25 percent of the excess (if any) of the corporation's regular tax (reduced by other credits) over $25,000.

Example (4). Spinnaker Inc. is a small business corporation for its 1998 tax year, and thus does not have an AMT liability. The corporation's regular tax liability less credits for 1998 was $65,000. Thus, the corporation's allowable AMT credit for 1998 is limited to $55,000.

Effective date. This provision applies to tax years beginning after December 31, 1997.

Act Sec. 401(a), adding Code Sec. 55(e); Act Sec. 401(b). Law at ¶ 5029. Committee Report at ¶ 10,335.

AMT Depreciation Adjustment

¶ 527

Background

Taxpayers who compute MACRS depreciation may be required to compute the depreciation a second time when determining if they are liable for the alternative minimum tax (AMT). For AMT purposes, the alternative depreciation system (ADS) of Code Sec. 168(g) is used for Sec. 1250 property and any other property depreciated using the straight-line method. Other property is depreciated using the 150 percent declining balance method and the applicable ADS depreciation period. The difference between the depreciation deduction computed for the regular income tax and the depreciation allowed for AMT purposes is an AMT tax adjustment. Similarly, taxpayers who elect to amortize certified pollution control facilities over 60 months for regular tax purposes are required to recompute their allowable deduction for AMT purposes.

AMT adjustment eliminated for property depreciated under straight-line method and recovery periods conformed for other property.—The AMT adjustment for the MACRS depreciation allowance claimed on Sec. 1250 property and any other property depreciated under MACRS using the straight-line method is eliminated, effective for property placed in service after December 31, 1998. Previously, the AMT adjustment for such property was equal to the difference between the depreciation claimed for regular tax purposes and the depreciation that would have been claimed using the MACRS alternative depreciation system (ADS) of Code Sec. 168(g). Under ADS, the straight-line method is used over recovery periods that are generally longer than the recovery period that would otherwise apply.

The 150-percent declining balance method, switching to the straight-line method for the first year it produces a larger deduction, must still be used to compute allowable AMT depreciation on MACRS property that is not Sec. 1250 property or is not depreciated using the straight-line method for regular tax purposes. However, effective for property placed in service after December 31, 1998, the MACRS recovery period that applies for regular tax purposes also applies for AMT purposes. The new law eliminates the requirement that the 150-percent declining balance method is used over the applicable ADS recovery period for AMT purposes.

Planning Note. The practical effect of the provision is that taxpayers will no longer be required to compute a separate AMT adjustment for MACRS residential rental and nonresidential real property (this property must be depreciated using the straight-line method for regular tax purposes) and any other MACRS property depreciated using the straight-line or 150-percent declining balance method for

regular tax purposes. An AMT depreciation adjustment will continue to be computed on MACRS 3-, 5-, 7-, and 10-year property which is depreciated using the 200-percent declining balance method for regular tax purposes. However, the adjustment will equal the difference between the depreciation claimed for regular tax purposes and the depreciation that would have been claimed using the 150-percent declining balance method over the same recovery period that is used for regular tax purposes.

Pollution control facilities. The Act also provides that the AMT depreciation adjustment for pollution control facilities amortized under Code Sec. 269 is computed under MACRS using the straight-line method, effective for property placed in service after December 31, 1998. Previously, the AMT adjustment for this property was computed using the MACRS ADS method.

Effective date. This provision applies to property placed in service after December 31, 1998. The former AMT adjustment rules continue to apply to property placed in service before 1999.

Act Sec. 402(a), amending Code Sec. 56(a)(1)(A)(i); Act Sec. 402(b), amending Code Sec. 56(a)(5). Law at ¶ 5031. Committee Report at ¶ 10,340.

Property and Casualty Insurance Companies

¶ 529

Background

Corporate taxpayers are subject to an alternative minimum tax preference that is based on the amount of their adjusted current earnings (ACE) for purposes of computing an alternative minimum tax liability. Under prior law, the ACE preference was not computed in different manner for property and casualty insurance companies that elected to be taxed only on taxable investment income for regular tax purposes.

ACE modified for certain insurance companies.—The new law provides that a property and casualty insurance company that elects to be taxed only on taxable investment income for regular tax purposes determines its adjusted current earnings (ACE) under the alternative minimum tax without regard to any amount not taken into account in computing its gross investment income. Thus, the ACE of such an electing company would be determined without regard to underwriting income or underwriting expense.

Effective date. The ACE modification applies to tax years beginning after December 31, 1997.

Act Sec. 1212(a), amending Code Sec. 56(g)(4)(B)(i); Act Sec. 1212(b). Law at ¶ 5031. Committee Report at ¶ 12,170.

REGULATED INVESTMENT COMPANIES

Thirty-Percent Gross Income Test

¶ 535

Background

Under the prior law 30-percent gross income test or "short-short" rule, a corporation did not qualify as a regulated investment company (RIC) for any tax

Background

year if 30 percent or more of its gross income was derived from the sale or disposition of stock, securities, foreign currencies, or options, futures, and similar positions thereon that were held for less than three months.

Thirty-percent gross income test repealed.—The 30-percent gross income test or "short-short" rule, under which a regulated investment company (RIC) had to derive less than 30 percent of its gross income from the sale or disposition of certain short-term assets held for less than three months has been repealed. These assets included (1) stock or securities; (2) options, futures, or forward contracts (other than on foreign currencies); and (3) foreign currencies or options, futures, or forward contracts on foreign currencies if such items are not directly related to the company's principal business of investing in stock, securities or options or futures on stock or securities. The repeal of the short-short rule should provide RICs with greater ability to hedge their investments and free them from significant record-keeping, compliance, and administrative costs.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1271(a), amending Code Sec. 851(b)(2), striking (b)(3), and redesignating (b)(4) as (b)(3); Act Sec. 1271(b), amending the material following Code Sec. 851(b)(3), as redesignated, amending Code Sec. 851(c), (d), (e)(1), and (e)(4), striking Code Sec. 851(g) and redesignating (h) as (g), striking Code Sec. 851(g)(3), as redesignated, and amending Code Secs. 817(h)(2) and 1092(f)(2); Act Sec. 1271(c). Law at ¶ 5261. Committee Report at ¶ 12,515.

REAL ESTATE INVESTMENT TRUSTS

Determination of Ownership of Shares or Interests

¶ 539

Background

Under the organizational requirements for qualification as a real estate investment trust (REIT), the beneficial ownership of a REIT must be held by at least 100 persons and the REIT may not be closely held, as evaluated under the personal holding company rules. These requirements must be satisfied for each tax year except the first tax year for which the entity elects to be treated as a REIT. Under prior law, if a REIT failed to ascertain the actual ownership of its outstanding shares or certificates of beneficial interest by requesting information from shareholders and to maintain the necessary records of ownership, as required under Reg. § 1.857-8, it was disqualified as a REIT.

Penalties for failure to determine ownership.—A real estate investment trust (REIT) that fails to ascertain the actual ownership of its outstanding shares or certificates of beneficial interest and to maintain the necessary records of ownership, as required under Reg. § 1.857-8, is subject only to monetary penalties, not disqualification as a REIT. Determining the REIT's ownership is necessary to establish that the beneficial ownership of the REIT is held by at least 100 persons and that it is not closely held, as evaluated under the personal holding company rules, for each year except the first tax year for which a REIT election is made.

If a REIT fails to comply with the regulatory rules on determining its ownership for a tax year, it must pay a $25,000 penalty upon receiving notice and demand from the IRS. If the REIT's failure to comply was due to intentional disregard of the requirements, the penalty is increased to $50,000. However, if the REIT's failure to comply was due to reasonable cause and not willful neglect, no penalty will be imposed.

The IRS may require a REIT that fails to comply with the regulatory rules to take curative actions to ascertain the actual ownership of its outstanding shares or certificates of beneficial interest. Such actions may take the form of curative demand letters to shareholders for information. A REIT that fails to take such requested actions must pay an additional penalty upon receiving notice and demand from the IRS. The additional penalty is equal to $25,000 or $50,000, depending on the amount of the initial penalty.

Closely held requirement. If a REIT complies with the regulatory rules on ascertaining its actual owners but does not know, or would not have known by exercising reasonable diligence, whether it failed to meet the requirement that it not be closely held, the REIT will be treated as having met the requirement.

PRACTICAL ANALYSIS. Keith Nakamoto, tax partner at the Chicago office of Coopers & Lybrand, L.L.P., notes that the new real estate investment trust (REIT) provisions recognize the unduly harsh penalties for failure to meet the REIT qualification rules—generally, loss of REIT status. In prior years, the failure to send demand letters to the shareholders (or to send demand letters that did not strictly comply with all of the provisions of the regulations) would disqualify the REIT. The new provisions recognize that the demand letters are an administrative requirement which is intended to determine if the REIT meets the minimum shareholder and closely-held ownership tests. If the REIT meets these tests but fails to send demand letters in accordance with the regulations, it now faces a penalty as opposed to disqualification. Similarly, the closely-held test is now based upon a reasonable effort to comply and a reasonable basis to know. Therefore, a shareholder can no longer create a disqualification event, if the REIT had no reasonable basis to know of the violation.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1251(a), striking Code Sec. 857(a)(2), redesignating (a)(3) as (a)(2), redesignating (f) as (g), and adding a new Code Sec. 857(f); Act Sec. 1251(b), amending Code Sec. 856(a)(6) and adding (k); Act Sec. 1263. Law at ¶ 5267 and 5269. Committee Report at ¶ 12,435.

Tenant Services Income

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Background

Under the income tests that an entity must satisfy on an annual basis to qualify as a real estate investment trust (REIT), at least 95 percent of the entity's gross income, other than gross income from prohibited transactions, must be

Background

derived from passive sources and at least 75 percent derived from real estate sources. For both tests, a permissible source of income is rent from real property.

Under prior law, rent did not include *any* amounts received with respect to real or personal property if the REIT furnished or rendered services to tenants or managed or operated property unless it did so through an independent contractor. Charges for services *customarily* furnished or rendered in connection with the rental of real property are treated as rent from real property.

***De minimis* rule for tenant services income.**—For purposes of the 95- and 75-percent gross income tests for qualification as a real estate investment trust (REIT), impermissible tenant services income is not treated as allowable rent from real property. Impermissible tenant services income with respect to real or personal property is any amount that the REIT directly or indirectly receives or accrues for (1) services that it provides to the property's tenants or (2) managing or operating the property. Charges for services *customarily* furnished or rendered in connection with the rental of real property, such as water, heat, light, general maintenance, trash collection, etc., still qualify as rent from real property.

In contrast to prior law, the Act now allows a REIT to receive a small amount of income from furnishing impermissible tenant services without causing all of the amounts received with respect to a property to fail to qualify as rent. The new *de minimis* rule establishes a one-percent threshold for impermissible tenant services income. Only if the REIT's impermissible tenant services income from a property exceeds one percent of all amounts received or accrued with respect to the property will all of the amounts fail to qualify as rent.

Amount of impermissible tenant services income. In establishing the amount of impermissible tenant services income, such amount must be at least 150 percent of the direct cost of providing the tenant services or managing or operating the property.

Exceptions to impermissible tenant services income. A REIT is not treated as providing services to tenants or as managing or operating the property, and has not generated impermissible tenant services income, if an independent contractor conducts the activities and the REIT does not derive any income from the independent contractor. The REIT could provide the services itself if the income generated would not constitute unrelated business taxable income under Code Sec. 512(b)(3) to a charitable organization, qualified retirement plan trust, or other organization described in Code Sec. 511(a)(2).

PRACTICAL ANALYSIS. Keith Nakamoto, tax partner at the Chicago office of Coopers & Lybrand, L.L.P., notes that many of the new provisions related to real estate investment trusts (REITs) recognize the unduly restrictive nature of the prior law on their ability to conduct business. In the past, REITs were required to retain independent contractors to perform certain nominal services for tenants, because any impermissible service tainted the entire revenue stream from that tenant. This taint disqualified the revenue as rents from real estate, which in turn jeopardized its ability to meet the various income tests.

For example, a REIT could employ maintenance personnel to clean common areas of an office building, but could not respond to a tenant's special request to clean up emergency spills on the tenant's leased space. Although this request is a normal customer need, the response to this need was potentially an impermissible service. In this situation, the REIT was forced to incur the cost of retaining an independent contractor on a permanent basis to perform such services, to lose customer goodwill by not responding to such requests, or to jeopardize its REIT status. The ability for REITs to provide these impermissible services on a limited basis removes a serious competitive disadvantage as compared to taxpayers who operate real estate in a non-REIT format. The provisions which relate to the retention of capital gains, the relaxation of the attribution rules for related tenant purposes, the expansion of the qualified hedging exception and the elimination of the 30% income test are other recognitions of the unduly restrictive nature of the prior law.

PRACTICAL ANALYSIS. Van Davis, of Dechert Price & Rhoads, Philadelphia, Pennsylvania, observes that the Taxpayer Relief Act of 1997 makes a number of small but significant changes to the rules governing real estate investment trusts (REITs). These changes relax some of the draconian sanctions for minor violations of the REIT rules and, more importantly, give REIT managers greater flexibility to manage a REIT's portfolio of properties or mortgages more actively and therefore to make REITs a more widely attractive investment vehicle.

As the mutual fund equivalent for real estate ownership, REITs are generally tax-exempt, and their income taxable directly to their shareholders. The price of this treatment has been that REITs must not engage in certain active management activities and must distribute virtually all of their income annually to shareholders.

REITs will have increased management flexibility because they will now be permitted to retain capital gain profits and pay tax on them, instead of distributing the profits to shareholders. As in the case of mutual funds, shareholders will be taxed on undistributed capital gains, but will get a credit for tax paid by the REIT (see ¶ 545).

REITs will no longer be limited in the amount of income derived from sales of property held less than four years or securities held less than one year. Such income was formerly limited to 30 percent of the REIT's total income, and the change here makes active portfolio management easier (see ¶ 547). REITs are allowed to provide *de minimis* amounts of special services to tenants without disqualifying the related rental income. All forms of interest rate hedging will be permitted (see ¶ 553). The classes of noncash income which are not required to be distributed are expanded (see ¶ 555). The period during which a REIT may hold property following a foreclosure has been extended to at least three years (see ¶ 551). Additional technical changes make it easier for REITs to

acquire subsidiaries (see ¶ 561) and to receive qualified rents from tenants who are also partners of the REIT (see ¶ 543).

These changes will spur the growth of aggressively self-managed REITs, which have already multiplied severalfold since 1992. REITs may well become the dominant equity vehicle for real estate ownership in the coming years. The modest revival of the mortgage REIT which has occurred in recent months may be spurred by the increased opportunity to manage and hedge a loan portfolio.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1252(a), striking Code Sec. 856(d)(2)(C) and the last sentence of (d)(2) and adding a new Code Sec. 856(d)(2)(C); Act Sec. 1252(b), adding Code Sec. 856(d)(7); Act Sec. 1263. Law at ¶ 5267. Committee Report at ¶ 12,440.

Attribution Rule for Purposes of Defining Rent

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Background

Under the income tests that an entity must satisfy on an annual basis to qualify as a real estate investment trust (REIT), at least 95 percent of the entity's gross income, other than gross income from prohibited transactions, must be derived from passive sources and at least 75 percent derived from real estate sources. For both tests, a permissible source of income is rent from real property.

Rent from real property does not include amounts received from entities in which the REIT owns a 10-percent or greater interest. Rent from real property also does not include amounts received with respect to real or personal property if the REIT provides services to the property's tenants or manages or operates the property. An exception to this rule is made for services provided through an independent contractor if the REIT does not receive any income from the independent contractor.

An independent contractor is any person who does not own more than 35 percent of the shares or certificates of beneficial interest in the REIT, either directly or indirectly. As a further limitation, a corporation cannot qualify as an independent contractor if more than 35 percent of the total combined voting power of its stock is owned directly or indirectly by one or more persons who own 35 percent or more of the REIT. A noncorporate person cannot qualify as an independent contractor if more than 35 percent of the interests in its assets or net profits is owned directly or indirectly by one or more persons who own 35 percent or more of the REIT.

For purposes of determining the REIT's percentage ownership of a corporation's stock or a noncorporate entity's assets and net profits, the Code Sec. 318 constructive ownership rules apply. In the case of attribution between shareholders and corporations, a 10-percent threshold is substituted for the 50-percent threshold in Code Sec. 318(a)(2)(C) and (3)(C). A minimum threshold for attribution did not apply to partnerships under prior law, so that any stock owned by a partnership was treated as owned by the partners and any stock owned by a partner was treated as owned by the partnership.

Twenty-five percent attribution rule for partners.—When computing a real estate investment trust's (REIT's) percentage ownership of a tenant or an independent contractor for purposes of determining whether certain payments qualify as rent, a special 25-percent attribution rule will apply to partners owning stock. The current 10-percent threshold for attribution between shareholders and corporations in this situation, which is substituted for the 50-percent threshold in Code Sec. 318(a)(2)(C) and (3)(C), continues to apply.

Amounts received from entities in which a REIT owns a 10-percent or greater interest are not treated as permissible rent from real property for purposes of the 95- and 75-percent gross income tests for qualification as a REIT. Further, rent does not include amounts received with respect to real or personal property if the REIT provides services to the property's tenants or manages or operates the property, unless the services are provided through an independent contractor. An independent contractor is generally any person (1) who does not own more than a 35-percent interest in the REIT, either directly or indirectly, and (2) in the case of noncorporate persons, not more than 35 percent of the interests in the assets or net profits of which is owned, directly or indirectly, by one or more persons who own 35 percent or more of the REIT.

In determining whether a REIT owns a 10-percent or greater interest in a tenant that could disqualify amounts received as rent, the Code Sec. 318 constructive ownership rules apply. However, under the new rule, in the case of attribution to a partnership under Code Sec. 318(a)(3)(A), only stock owned by partners who, directly or indirectly, own 25 percent or more of the capital or profits interest in the partnership is treated as owned by the partnership. Under prior law, even partners with minute interests in the partnership had all of the stock they owned attributed to the partnership.

> **Example (1).** A partnership owns 12% of the shares of a REIT. A 30% interest in the partnership is owned by a partner who also owns a 15% interest in the REIT's corporate tenant. The partner's 15% ownership interest in the tenant is attributed to the partnership. Since the partnership owns 10% or more of the REIT, the partner's 15% interest in the tenant that is attributed to the partnership is attributed to the REIT. Thus, the REIT has a disqualifying interest in the tenant and amounts paid by the tenant to the REIT cannot be treated as rent.

This 25-percent rule for attribution to partnerships is also extended to the definition of an independent contractor. Thus, under the attribution rule, a contractor providing tenant services will not be denied independent contractor status if REIT shares are owned by a partnership and a partner owns a 35-percent or greater interest in the contractor but less than a 25-percent interest in the partnership.

> **Example (2).** A partnership owns 50% of a REIT's shares. A 30% interest in the partnership is owned by a partner who also owns a 45% interest in a contractor who performs services for the REIT's tenant. The partner's 45% interest in the contractor is attributed to the partnership. Thus, since more than 35% of the contractor is owned indirectly by the partnership which owns more than 35% of the REIT, the contractor is not independent and amounts paid by the tenant to the REIT cannot be treated as rent.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1253, amending Code Sec. 856(d)(5); Act Sec. 1263. Law at ¶ 5267. Committee Report at ¶ 12,445.

Retained Capital Gains

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Background

Although real estate investment trusts (REITs) are subject to a tax on net capital gain, a REIT can pay capital gain dividends to its shareholders in order to reduce its capital gains tax liability. Shareholders or holders of beneficial interests in the REIT treat capital gain dividends as long-term capital gains and are taxed accordingly. Under prior law, if a REIT retained its capital gains for the year instead of paying capital gain dividends, the retained capital gains were taxed twice: first, at the REIT level, and second, at the shareholder level when later distributed.

In contrast, regulated investment companies (RICs) can retain and pay tax on their long-term capital gains while their shareholders include their share of the retained capital gain in income and are deemed to have paid an appropriate share of the tax. There was no corresponding rule for REITs under prior law.

Credit for tax paid on retained capital gains.—The rules for taxing a real estate investment trust's (REIT's) retained capital gains are modified to correspond to the rules for regulated investment companies (RICs). Thus, a REIT may elect to retain, rather than distribute, its net long-term capital gains and pay the tax on such gains, while its shareholders include their proportionate share of the undistributed long-term capital gains in income and receive a credit for their share of the tax paid by the REIT.

Planning Note. Even though a REIT is taxed on retained capital gains, it may wish to retain them, rather than distribute them to shareholders, in order to preserve a source of funds for working capital.

Specifically, the REIT may designate amounts as undistributed capital gains in respect of its shareholders' shares or its holders' beneficial interests. The designation must be made in a written notice to shareholders or holders of beneficial interests and mailed at any time prior to the expiration of 60 days after the close of the REIT's tax year or mailed with its annual report for the tax year. The REIT must then pay tax on the net capital gain under Code Sec. 857(b)(3)(A)(ii) within 30 days after the close of its tax year.

At the end of the REIT's tax year, the amount designated by the REIT must be treated by the shareholders or holders of beneficial interests as long-term capital gains for their tax year in which the last day of the REIT's tax year falls. However, the includible amount cannot exceed the portion of the amount on which the REIT was required to pay capital gains tax under Code Sec. 857(b)(3)(A)(ii) and that the shareholders or holders would have received if the amount had been distributed as capital gain dividends. The shareholders or holders of beneficial interests are treated as having paid the capital gains tax imposed on the REIT on the designated amounts included in their long-term capital gains and are allowed a credit or refund for the tax deemed paid.

Basis adjustment. The shareholders or holders of beneficial interests can increase the adjusted basis of their shares or beneficial interests by the difference between the designated amounts included in their long-term capital gains and the tax deemed paid with respect to their shares or beneficial interests.

Earnings and profits adjustment. The REIT's earnings and profits and the earnings and profits of a REIT shareholder that is a corporation should be adjusted for the undistributed capital gains according to regulations to be prescribed by the IRS.

Conforming basis adjustment rule for RIC shareholders. The rules on undistributed capital gains of regulated investment companies (RICs) have been amended to provide a basis adjustment rule that conforms to the rule for REITs. Thus, RIC shareholders who have been designated an amount as capital gains with respect to their shares and are deemed to have paid the capital gains tax imposed on the RIC can increase the adjusted basis of their shares by the difference between the amount of the includible gains and the tax deemed paid.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1254(a), redesignating Code Sec. 857(b)(3)(D) as (b)(3)(E) and adding a new Code Sec. 857(b)(3)(D); Act Sec. 1254(b), amending Code Secs. 852(b)(3)(D)(iii) and 857(b)(7)(A)(i); Act Sec. 1263. Law at ¶ 5263 and 5269. Committee Report at ¶ 12,450.

Thirty-Percent Gross Income Test

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Background

An entity cannot qualify as a real estate investment trust (REIT) unless its income is derived primarily from passive sources and real estate sources. In addition, under prior law, a REIT had to derive less than 30 percent of its gross income from the sale or disposition of (1) stock or securities held for less than one year, (2) certain real property held for less than four years, and (3) property in a prohibited transaction. Any gains from the sale, exchange, or distribution of any property after the adoption of a complete plan of liquidation of the REIT were not taken into account for the 30-percent gross income test.

Thirty-percent gross income test repealed.—The 30-percent gross income test for qualification as a real estate investment trust (REIT) has been repealed. Thus, a REIT no longer has to meet the requirement that it derive less than 30 percent of its gross income from the sale or disposition of (1) stock or securities held for less than one year, (2) real property held for less than four years, including real property interests and interests in mortgages on real property but not foreclosure property, and (3) property in a prohibited transaction.

According to the House Committee Report, the 30-percent gross income test is unnecessary because the 75-percent asset test provides sufficient safeguards to ensure that the REIT acts as a pass-through entity for real estate investors. The 75-percent asset test generally requires that at least 75 percent of the value of the REIT's total assets be comprised of real estate assets, cash and cash items, and government securities and that no more than 25 percent of the value of the REIT's total assets be comprised of securities of any other single issuer.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1255(a), amending Code Sec. 856(c)(3), striking (c)(4) and (8), and redesignating Code Sec. 856(c)(5), (6), and (7), as (c)(4), (5), and (6), respectively; Act Sec. 1255(b), amending Code Sec. 856(c)(5)(G), as redesignated, and amending Code Sec. 857(b)(5) and (b)(6)(C); Act Sec. 1263. Law at ¶ 5267 and 5269. Committee Report at ¶ 12,455.

Earnings and Profits Rules

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Background

The rules for taxing real estate investment trusts (REITs) and their beneficiaries do not apply for a particular tax year unless the entity qualified as a REIT for all tax years beginning after February 28, 1986, or, as of the close of the tax year, the REIT had no earnings and profits accumulated in any year in which it was not treated as a REIT (i.e., a non-REIT year). Thus, during its first REIT year, an entity must distribute any earnings and profits that were accumulated in non-REIT years and, under prior law, such distributions were treated as made from the most recently accumulated earnings and profits.

Ordering rule for earnings and profits distributions.—If a real estate investment trust (REIT) must make a distribution to comply with the requirement that, at the close of the tax year, it have no earnings and profits that were accumulated in any year in which it was not treated as a REIT (i.e., a non-REIT year), the distribution is treated as made from its earliest accumulated earnings and profits. This replaces the prior ordering rule which treated such a distribution as made from the most recently accumulated earnings and profits.

Caution. A distribution of earnings and profits that is necessary to purge the REIT of earnings and profits from a non-REIT year is not treated as a deductible dividends distribution.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1256, adding Code Sec. 857(d)(3); Act Sec. 1263. Law at ¶ 5269. Committee Report at ¶ 12,460.

Foreclosure Property

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Background

Income from foreclosure property receives special treatment under the rules for real estate investment trusts (REITs). A REIT's net income from foreclosure property is taxed at the highest corporate tax rate set forth in Code Sec. 11(b). In addition, under the income tests that an entity must satisfy on an annual basis to qualify as a REIT, at least 95 percent of the entity's gross income, other than gross income from prohibited transactions, must be derived from passive sources and at least 75 percent derived from real estate sources. For both tests, a permissible source of income is income and gain derived from foreclosure property.

Background

Foreclosure property is defined as real property and any personal property incident to such real property that is acquired by the REIT as a result of any of the following: (1) a bid at foreclosure, or (2) an agreement or process of law upon a default or imminent default on a lease of the property or a debt that the property secured. Under prior law, such property ceased to be foreclosure property on the date that was two years after the date that the REIT acquired the property. If the REIT needed more time to liquidate its interests in the foreclosure property, it was able to request extensions of the two-year grace period up to the date that was six years after the date that the REIT acquired the property.

The grace period terminates and property ceases to be foreclosure property if it is used for certain active purposes, such as where the REIT uses the property in a trade or business, other than through an independent contractor, more than 90 days after the property was acquired. A REIT has to elect to treat property as foreclosure property and, under prior law, such an election was irrevocable.

Grace period for foreclosure property treatment extended.—The grace period has been extended for treating real property and any personal property incident to such real property as foreclosure property where it was acquired by a real estate investment trust (REIT) as a result of a bid at foreclosure or upon a default or imminent default on a lease of the property or a debt that the property secured.

Thus, when determining the tax on a REIT's net income from foreclosure property and the amount of income and gain derived from foreclosure property for purposes of the 95- and 75-percent gross income tests for qualification as a REIT, property will not cease to be foreclosure property until the close of the third tax year following the tax year in which the REIT acquired the property. A REIT is limited to one extension of the grace period, which cannot extend the period beyond the close of the third tax year following the last tax year of the initial grace period.

Revocation of election. Although a REIT must make an election to treat property as foreclosure property, this election is now revocable. To revoke an election for a tax year, the REIT must file a revocation on or before the due date, including extensions, for filing its tax return for the tax year.

Caution. Once an election to treat property as foreclosure property has been revoked, it may not be made again for that property.

Disqualifying activities. In general, the grace period for treating property as foreclosure property terminates if the REIT uses the property in a trade or business, other than through an independent contractor, more than 90 days after the property was acquired. Under the Act, property is not used in a trade or business by a REIT to the extent that the REIT's activities would not cause amounts directly or indirectly received or accrued with respect to the property to be treated as anything other than rents from real property.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1257(a), amending Code Sec. 856(e)(2) and (3); Act Sec. 1257(b), amending Code Sec. 856(e)(5); Act Sec. 1257(c), amending Code Sec. 856(e)(4); Act Sec. 1263. Law at ¶ 5267. Committee Report at ¶ 12,465.

Payments Under Hedging Agreements

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Background

Under the income tests that must be satisfied by an entity on an annual basis to qualify as a real estate investment trust (REIT), at least 95 percent of the entity's gross income, other than gross income from prohibited transactions, must be derived from passive sources and at least 75 percent derived from real estate sources. Further, under prior law, a REIT had to derive less than 30 percent of its gross income from the sale or disposition of (1) stock or securities held for less than one year, (2) certain real property held for less than four years, and (3) property in a prohibited transaction.

Under prior law, qualifying income for the 95-percent gross income test and a security for the former 30-percent gross income test included a payment to a REIT under a bona fide interest rate swap or cap agreement entered into by the REIT to hedge any variable rate debt that was incurred to acquire or carry real estate assets. Also, any gain from the sale or disposition of such an agreement was treated as qualifying income and as a security for the two tests.

Payments from hedging treated as qualifying income.—In order to provide real estate investment trusts (REITs) with flexibility in managing risk for their shareholders, the types of payments under interest rate and hedging agreements that will be treated as permissible income for purposes of the 95-percent gross income test for qualification as a REIT have been expanded. Now, except as otherwise provided by regulations, qualifying income for purposes of the 95-percent test includes any payment to a REIT under an interest rate swap or cap agreement, option, futures contract, forward rate agreement, or any similar financial instrument, entered into by the REIT to reduce its interest rate risk with respect to debt that was or will be incurred to acquire or carry real estate assets. Gain from the sale or other disposition of such hedges is also treated as qualifying passive income.

Planning Note. A REIT can take advantage of any type of hedge that reduces the risk associated with fluctuating interest rates and be assured that payments under the hedging agreement will be treated as qualifying passive income.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1258, amending Code Sec. 856(c)(5)(G), as redesignated by Act Sec. 1255; Act Sec. 1263. Law at ¶ 5267. Committee Report at ¶ 12,470.

Excess Noncash Income

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Background

The rules for taxing real estate investment trusts (REITs) and their beneficiaries do not apply to a REIT for a tax year unless it satisfies certain distribution requirements by paying out nearly all of its taxable income in the form of dividends to its shareholders. The distributed amount must equal or exceed (1) the sum of 95 percent of the REIT's taxable income for the year (determined without

Background

regard to the dividends paid deduction and excluding any net capital gain) and 95 percent of the excess of the net income from foreclosure property over the tax imposed on such income, less (2) any excess noncash income.

Under prior law, excess noncash income of cash-basis REITs included the excess of the amount includible in gross income from debt instruments issued for property under Code Sec. 1274 over the amount of money and the fair market value of property received under such instruments.

Definition of excess noncash income expanded.—The types of items treated as excess noncash income that are not subject to the distribution requirements for real estate investment trusts (REITs) have been expanded. Accrual-basis REITs, as well as cash-basis REITs, can treat as excess noncash income the difference between the amounts includible in gross income from instruments to which Code Sec. 860E(a) or 1272 applies, and the amount of money and the fair market value of other property received during the tax year under such instruments. In general, Code Sec. 860E(a) covers excess inclusions attributable to residual interests in a real estate mortgage investment conduit (REMIC), and Code Sec. 1272 covers debt instruments with original issue discount (OID). Furthermore, excess noncash income now includes cancellation of debt income.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1259, striking Code Sec. 857(e)(2)(B), amending (e)(2)(C) and redesignating as (e)(2)(B), and adding a new Code Sec. 857(e)(2)(C) and (D); Act Sec. 1263. Law at ¶ 5269. Committee Report at ¶ 12,475.

Prohibited Transaction Safe Harbor

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Background

A real estate investment trust (REIT) is subject to a tax equal to 100 percent of the net income derived from prohibited transactions. A prohibited transaction is a sale or disposition of property held for sale in the ordinary course of a trade or business other than foreclosure property.

Under a safe harbor rule, certain sales of real estate assets held by a REIT for at least four years are not treated as prohibited transactions, subject to a number of limitations. During the tax year, a REIT cannot make more than seven sales of such property or the aggregate adjusted bases of property sold cannot exceed 10 percent of the aggregate bases of all of the REIT's assets at the beginning of the tax year. Under prior law, only foreclosure property was ignored for purposes of the seven sales or the 10-percent aggregate bases limitation.

Involuntary conversions ignored for prohibited sales rules.—In addition to foreclosure property, involuntarily converted property is ignored for purposes of the prohibited transactions rules that subject a real estate investment trust's (REIT's) net income from prohibited transactions to a 100-percent tax. A safe harbor rule excludes certain sales of real estate assets held by a REIT for at least four years from the prohibited transactions rules. However, a REIT generally cannot, during the tax year, make more than seven sales of property or the

aggregate adjusted bases of property sold cannot exceed 10 percent of the aggregate bases of all of the REIT's assets at the beginning of the tax year. Under the Act, sales of property covered by the Code Sec. 1033 involuntary conversion rules, as well as sales of foreclosure property, do not count against the seven sales or the 10-percent aggregate bases limits.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1260, amending Code Sec. 857(b)(6)(C)(iii); Act Sec. 1263. Law at ¶ 5269. Committee Report at ¶ 12,480.

Shared Appreciation Mortgages

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Background

Under prior law, a shared appreciation provision was defined as a provision connected with an obligation secured by real property that entitled a real estate investment trust (REIT) to a portion of any gain realized on the sale or exchange of the property or any gain that would be realized if the property were sold on a specified date. For purposes of the 95- and 75-percent gross income tests that an entity must satisfy to qualify as a REIT and for purposes of determining a REIT's income from prohibited transactions, any income derived from a shared appreciation provision is treated as gain recognized on the sale of the secured property.

Under a safe harbor rule, certain sales of real estate assets held by a REIT for at least four years are not treated as prohibited transactions, subject to a number of limitations. In applying the safe harbor, a REIT is treated as having sold a secured property when it recognizes any income from a shared appreciation provision. Under prior law, dispositions in bankruptcy proceedings did not receive special treatment for purposes of the safe harbor.

Shared appreciation clarified, bankruptcy safe harbor added.—The definition of a shared appreciation provision has been clarified for purposes of the 95- and 75-percent gross income tests for qualification as a real estate investment trust (REIT) and for purposes of determining a REIT's income from prohibited transactions. A shared appreciation provision is a provision connected with an obligation secured by real property that entitles a REIT to (1) a portion of any gain realized on the sale or exchange of the property, (2) any gain that would be realized if the property were sold on a specified date, or (3) under the Act, appreciation in value as of a specified date. Any income derived from a shared appreciation provision is treated as gain recognized on the sale of the secured property.

Bankruptcy safe harbor rule. Under one of the conditions for excluding certain sales of real estate assets from tax under the prohibited transactions rules, the property must be held for at least four years. If a REIT is treated as having sold secured property because it recognized income from a shared appreciation provision, the property is treated as held for at least four years in certain bankruptcy situations. That is, the four-year holding period requirement will be satisfied if (1) the secured property is sold or disposed of in a bankruptcy case under title 11 of the U.S. Code, (2) the seller is under the court's jurisdiction in the case, and (3) the disposition is required by the court or is pursuant to a plan approved by the court.

Caution. This safe harbor rule for bankruptcy situations will not apply if the REIT acquired the secured property with the intent to evict or foreclose or if the

REIT knew or had reason to know that a default on the obligation secured by the property would occur.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1261(a), redesignating Code Sec. 856(j)(4) as (j)(5), and adding a new Code Sec. 856(j)(4); Act Sec. 1261(b), amending Code Sec. 856(j)(5)(A)(ii); Act Sec. 1263. Law at ¶ 5267. Committee Report at ¶ 12,485.

Wholly Owned Subsidiaries

¶ 561

Background

Under prior law, a qualified real estate investment trust (REIT) subsidiary was defined as a corporation if all of its stock was held by the REIT at all times during the period such corporation was in existence.

Definition of qualified REIT subsidiary modified.—A qualified real estate investment trust (REIT) subsidiary is not treated as a separate corporation from the REIT. Thus, all of its assets, liabilities, and income, deduction, and credit items are treated as the REITs. The definition of a qualified REIT subsidiary has been modified to include a corporation if all of its stock is held by the REIT. The stock no longer has to be held at all times during the period such corporation was in existence.

Caution. If an existing corporation is acquired by a REIT and is a qualified REIT subsidiary, all of its pre-REIT earnings and profits (E&P) must be distributed before the end of the REIT's tax year under the E&P distribution rules.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1262, amending Code Sec. 856(i)(2); Act Sec. 1263. Law at ¶ 5267. Committee Report at ¶ 12,490.

OTHER

Tax Benefits for Amtrak

¶ 565

Background

A corporation can generally carry back a net operating loss (NOL) to the three years immediately preceding a loss year. Limitations apply to carryforwards of NOLs of predecessors. No special provision existed under prior law concerning the carryback of NOLs by Amtrak.

Election to carry back existing Amtrak NOL carryovers.—In an measure designed to fund a portion of the operating expenses of the National Railroad Passenger Corporation (Amtrak), the Act allows Amtrak to elect to treat up to $2.323 billion as a payment of tax split evenly between its first tax year ending after September 30, 1997, and its following tax year. Specifically, the amount treated as tax paid for each of these tax years is 50 percent of the lesser of:

(1) 35 percent of Amtrak's aggregate net operating loss carryforwards to its first tax year ending after September 30, 1997;

(2) the aggregate net tax liability (i.e., tax imposed less credits) for pre-1971 tax years of Amtrak's predecessor railroads, which were relieved of their responsibility to provide intercity passenger rail service by the Rail Passenger Service Act of 1970; or

(3) $2.323 billion.

If Amtrak elects application of the Act's provision, it must use the refund of any amounts that are considered as tax paid (plus interest) to finance the acquisition or maintenance of its equipment or operating facilities or to make payments to States that are not serviced by Amtrak, which are in turn required to use the payments for similar purposes or to purchase intercity passenger service from Amtrak.

Tax consequences of Amtrak's election. The effect of the provision is to allow Amtrak to use its current NOL carryovers against pre-1971 tax imposed against its predecessor companies and to permit Amtrak to file for a refund of its tax deemed paid in its current and next following tax years. The election will result in a reduction in Amtrak's NOL carryovers in an amount equal to the deemed tax paid, divided by 0.35. Also, appropriate adjustments will be made by the Treasury to the tax accounts of the predecessor railroads in order to reduce their net tax liabilities which are offset by the carryback of Amtrak's NOLs. Only Amtrak is permitted to a refund or credit by reason of this provision.

Also, Amtrak expenditures of refunded amounts are not deductible and are not taken into account in determining the tax basis of any Amtrak properties. Payments to non-Amtrak States are likewise nondeductible.

Tax benefits contingent on Amtrak reform legislation. No refund of the deemed tax payments is permitted unless federal legislation is enacted after July 29, 1997, which authorizes Amtrak reforms. No interest will accrue on such refunds before the 45th day following the date Amtrak reform legislation is enacted.

Effective date. This provision is effective on August 5, 1997.

Act Sec. 977. Law at ¶ 7019. Committee Report at ¶ 10,930.

Reserves of Thrift Institutions

¶ 573

Background

The Small Business Job Protection Act (Act) (P.L. 104-188) repealed the reserve method of accounting for bad debts of thrift institutions under Code Sec. 593 (percentage-of-taxable income method). Pre-1988 reserves are subject to the provisions of Code Sec. 593(e), which require recapture in the case of certain excess distributions to, and redemptions of, shareholders. The Act also provided that a financial institution described in Code Sec. 581 can elect to be treated as an S corporation, as long as it does not use the reserve method of accounting for bad debts. Under Code Sec. 1374, a corporate-level tax is imposed on the net unrealized built-in gains of a C corporation that converts to an S corporation during the 10-year period beginning on the date of conversion. Before the Taxpayer Relief Act of 1997, the rules under Code Sec. 593(e) did not provide for distributions to shareholders by financial institutions that elect S corporation status.

Pre-1988 reserve rules for S corporations clarified.—The Code Sec. 593(e) rules for the treatment of pre-1988 bad debt reserves as applied to Code Sec. 581 thrift and former thrift financial institutions that elect S corporation status are clarified. The accumulated adjustment account defined under Code Sec. 1368 of the S corporation is treated in the same manner as the post-1951 earnings and profits of other financial institutions when determining whether the pre-1988 reserve is restored to income. Further, the rules of Code Sec. 1374 will apply to distributions that trigger Code Sec. 593(e), even if the distribution occurs after the Code Sec. 1374 10-year period.

Effective date. The amendment applies to tax years beginning after December 31, 1995.

Act Sec. 1601(f)(5)(A), amending Code Sec. 593(e)(1)(A). Act Sec. 1601(f)(5)(B), amending Code Sec. 1374(d)(7). Act Sec. 1601(j)(1). Law at ¶ 5189 and 5377. Committee Report at ¶ 13,665.

Permitted Assets of FASITs

¶ 575

Background

A financial asset securitization investment trust (FASIT) is a statutory entity designed to securitize debt obligations such as credit card receivables, home equity loans and auto loans. A FASIT is a pass-through entity that holds specified securities and issues interests in asset-backed securities to investors. The regular interest in a FASIT issued to investors is treated as debt for federal income tax purposes. Special rules are provided under Code Sec. 860L, including rules for the qualification of a FASIT, interests in a FASIT and prohibited transactions. A 100-percent excise tax applies to net income derived from prohibited transactions.

Prior to the Taxpayer Relief Act of 1997, to qualify as a regular interest in a FASIT, the instrument had to meet certain requirements *after* the startup date of the FASIT (the first tax year of the FASIT). Also, exceptions to the prohibited transaction rules applied to income from seven types of permitted dispositions.

FASIT corrections.—To qualify as a regular interest in a financial asset securitization investment trust (FASIT), which is treated as debt for federal income tax purposes, the instrument must meet certain requirements under Code Sec. 860L *on or after* the startup date of the FASIT (the first tax year of the FASIT). The Act corrects a cross-reference to Code Sec. 860I contained in the rule for the treatment of property held on the startup date. As corrected, property held, or treated as held under the deferral of gain recognition rule in Code Sec. 860I(b)(2), by the entity as of the startup date is considered contributed on that day by the holder of the ownership interest.

Exceptions from the tax on prohibited transactions. The 100-percent excise tax on net income from prohibited transactions does not apply to the net income from the disposition of a permitted asset that is foreclosure property. The exception from the excise tax for net income from a permitted disposition is clarified with respect to the similar exceptions that apply to a real estate mortgage investment conduit (REMIC) under Code Sec. 860F(a)(2)(A) and Code Sec. 860F(a)(5). The exceptions apply as if the FASIT was treated as a REMIC and permitted assets (other than cash and cash equivalents) were treated as qualified mortgages.

The exception from the excise tax for net income from a permitted disposition is expanded to include income from the disposition of former hedge assets. The exception applies to income derived from the disposition of property that is no longer hedge property under Code Sec. 860L(c)(1)(D) on the date of disposition. The exception also applies to income derived from the disposition of a contract right to acquire a former hedge asset.

Effective date. The provision generally is effective on September 1, 1997.

Act Sec. 1601(f)(6)(A), amending Code Sec. 860L(b)(1)(A); Act Sec. 1601(f)(6)(B), amending Code Sec. 860L(d)(2); Act Sec. 1601(f)(6)(C), amending Code Sec. 860L(e)(2)(B); Act Sec. 1601(f)(6)(D), amending Code Sec. 860L(e)(3)(A); Act Sec. 1601(f)(6)(E)(i), adding Code Sec. 860L(e)(3)(D); and Act Sec. 1601(f)(6)(E)(ii), amending Code Sec. 860L(e)(2)(A); Act Sec. 1601(j)(1). Law at ¶ 5271. Committee Report at ¶ 13,670.

Blue Cross and Blue Shield Organizations

¶ 577

Background

The Tax Reform Act of 1986 provided special rules (Code Sec. 833) to compute the taxable income of Blue Cross and Blue Shield Organizations. One benefit allows these companies a deduction (not to exceed taxable income) equal to one quarter of the year's annual claims and administrative expenses incurred less the prior year's surplus for regular tax. Until the Taxpayer Relief Act of 1997, the treatment of expenses incurred under cost-plus contracts was not clarified.

Treatment of cost-plus contracts.—The Act clarifies that, for purposes of the Code Sec. 833 deduction, liabilities incurred during the tax year under cost-plus contracts are added to claims incurred. Similarly, for purposes of the Code Sec. 833 deduction, expenses incurred in connection with cost-plus contracts are added to expenses incurred.

Effective date. The provision is effective for tax years beginning after December 31, 1986.

Act Sec. 1604(d)(2)(A), amending Code Sec. 833(b)(1)(A)(i) and (ii). Act Sec. 1604(d)(2)(B). Law at ¶ 5259. Committee Report at ¶ 13,945.

Chapter 6

Tax-Exempt Organizations

TAX-EXEMPT STATUS

State Worker's Compensation Act Companies

¶ 601

Background

Prior to the Taxpayer Relief Act of 1997, the IRS took the position that organizations were not engaged in a tax-exempt activity if they provided insurance to their members or other individuals. Such activity was considered by the IRS as either a for-profit business, or an economy or convenience for the business of a member who did not have to then individually obtain insurance. Tax exemption under Code Sec. 501(c)(6) was available to insurance risk pools that assigned any insurance policies and administrative functions to their members, served an important common interest of their members, and were membership organizations financed in part by membership dues. State insurance risk pools could also qualify for tax-exempt status under Code Sec. 501(c)(4) as social welfare organizations, but they were constrained by the restrictions on the provision of "commercial-type insurance" contained in Code Sec. 501(m). State insurance risk pools also qualified for tax-exempt status under Code Sec. 115 as serving an essential governmental function of State.

Tax-exempt status of state worker's compensation act companies.—Code Sec. 501(c)(27) has been clarified with respect to the tax-exempt status of certain state worker's compensation act companies. An organization is exempt from taxation if it is created by state law and is organized and operated to exclusively provide worker's compensation insurance and related coverage incidental to the insurance. According to the House Committee Report, related coverage includes liability under federal worker's compensation laws. The worker's compensation insurance must be required by state law or state law must provide significant disincentives if an employer does not purchase the insurance. Significant

disincentives according to the House Committee Report include loss of exclusive remedy or forfeiture of affirmative defenses. Also, the organization must provide the insurance to any employer in the state that is seeking such insurance and meets other reasonable requirements.

Further, a financial commitment must be made by the state through the extension of its full faith and credit to the organization's initial debt or the provision of initial operating capital to the organization. For periods following enactment, the organization's assets must revert to the state upon dissolution or state law will not permit the dissolution of the organization. Finally, the majority of the organization's board of directors or oversight body must be appointed by the state's chief executive officer (or other executive branch official), by the state legislature, or by both.

Effective date. These provisions apply to tax years beginning after December 31, 1997.

Act Sec. 963(a) and (b), amending Code Sec. 501(c)(27); Act Sec. 963(c). Law at ¶ 5171. Committee Report at ¶ 10,845.

State-Sponsored Organizations Providing Health Care Coverage

¶ 603

Background

Under current law, a state may establish organizations whose purpose is to provide medical insurance coverage for care to those residents of the state who would otherwise be uninsurable, or who would be forced, due to their particular condition, to pay unreasonably high rates. These "high risk" individuals must still pay for their coverage, but they often pay premiums at a rate considerably less than they would otherwise be required to pay, if they could acquire insurance at all. The state will also subsidize any premiums that the high-risk individuals are unable to pay on their own.

Prior to the Taxpayer Relief Act of 1997, the children of these high-risk individuals did not qualify for the subsidized insurance benefits that their parents received.

Definition of "high-risk" individuals expanded.—The definition of "high-risk" individuals eligible to receive care from nonprofit, state-sponsored medical care providers has been expanded to include the spouse and the children of a current high-risk individual if certain requirements are met. This was done in order to help provide medical coverage to otherwise uninsured spouses and children. For a child of a high-risk individual to qualify for coverage, the following requirements must be satisfied: (1) the taxpayer is allowed an exemption for the child in the tax year; (2) the child has not reached 17 years of age by the end of the tax year; and (3) the child is a son or daughter, stepson or stepdaughter, foster child, or dependent of a son or daughter of the taxpayer.

Effective date. This provision is effective for tax years beginning after December 31, 1997.

Act Sec. 101(c), amending Code Sec. 501(c)(26); Act Sec. 101(e). Law at ¶ 5171. Committee Report at ¶ 10,125.

Cooperative Hospital Service Organizations

¶ 605

Background

An entity does not qualify as a tax-exempt cooperative hospital service organization unless it is operated solely to perform one or more of the enumerated services listed in Code Sec. 501(e)(1)(A) for its member hospitals. Although these services include billing and collection services, it was unclear prior to the Taxpayer Relief Act of 1997 whether the purchase of patron accounts receivable on a recourse basis was considered a permissible billing and collection service.

Treatment of receivables purchased by cooperative hospital service organizations.—The list of enumerated services that can be performed by a tax-exempt cooperative hospital service organization for its members has been clarified with respect to permissible billing and collection services. Billing and collection services provided by such an organization include the purchase of patron accounts receivable on a recourse basis. Accordingly, if member hospitals retain the risk of nonpayment of their accounts receivables, the cooperative hospital service organization may advance cash on the basis of such receivables.

Effective date. This provision applies to tax years beginning after December 31, 1996.

Act Sec. 974, amending Code Sec. 501(e)(1)(A). Law at ¶ 5171. Committee Report at ¶ 10,915.

Hospitals Participating in Provider-Sponsored Organizations

¶ 606

Background

An organization must meet the following tests in order to qualify for tax-exempt status under Code Sec. 501(c)(3):

(1) it must be organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, for the prevention of cruelty to children or animals, for the purpose of testing consumer products for public safety, or to foster national or international amateur sports competition (but only if no part of its activities involves provision of athletic facilities or equipment); and

(2) no portion of its net income can inure to the benefit of private shareholders or individuals.

Nonprofit hospitals are generally considered to be operated for charitable purposes if their services benefit the community as a whole.

In addition, a Code Sec. 501(c)(3) organization cannot attempt to influence legislation as any substantial part of its activities. Such organizations are also prohibited from providing commercial-type insurance as a substantial portion of its activities.

A nonprofit organization can enter into a joint venture with a for-profit organization without jeopardizing its tax-exempt status provided that the venture itself, and the tax-exempt's participation in the venture, furthers a charitable purpose. It must also be established that the arrangement does not create improper

Background

private inurement or confer more than an incidental benefit on any private individual. The IRS examines the facts and circumstances of each venture to determine whether these requirements are met.

Hospital's participation in provider-sponsored organizations expressly permitted.—A tax-exempt organization may participate in a joint venture with a for-profit organization if a two-prong test is satisfied: (1) the venture itself furthers a charitable purpose and (2) the sharing of profits and losses does not result in impermissible private inurement or a more than incidental benefit to any individual. The new law provides that a hospital, or other 501(c)(3) organization, will not fail to be treated as organized and operated solely for a charitable purpose based solely on its participation in a provider-sponsored organization (PSO), as defined in section 1845(a)(1) of the Social Security Act. Thus, the first prong of the two-part test is deemed satisfied. This provision applies regardless of whether the PSO is itself a tax-exempt organization.

The requirement that there be no private inurement or benefit to any individual has not been changed. For purposes of this test, any person who has a material financial interest in the PSO is treated as a private shareholder or individual with respect to the hospital itself. Each PSO arrangement will be evaluated based upon the individual facts and circumstances to determine whether there has been private inurement or more than an incidental private benefit.

There has been no change to the present prohibitions on lobbying and political activities by charitable organizations. Also, the prohibition against providing commercial-type insurance continues to apply.

Effective date. This provision is effective on August 5, 1997.

Act Sec. 4041 of the Balanced Budget Act of 1997, redesignating Code Sec. 501(o) as Code Sec. 501(p), and adding new Code Sec. 501(o). Law at ¶ 5171. Committee Report at ¶ 20,035.

Pension Business of Certain Insurers

¶ 607

Background

Under current law, a charitable Code Sec. 501(c)(3) organization or a Code Sec. 501(c)(4) civic league or other social welfare organization providing commercial-type insurance is granted tax-exempt status only if no substantial portion of its activities consists of providing commercial-type insurance. This provision was enacted by the Tax Reform Act of 1986 (P.L. 99-514) which also provided special rules for Mutual of America and for Teachers Insurance Annuity Association—College Retirement Fund so that the portion of the business of these two organizations attributable to pension business was not subject to this rule. This exemption had been effective since the enactment of the provision in 1986.

Repeal of exemption from tax with respect to pension business of certain insurers.—The Taxpayer Relief Act of 1997 repeals the special rules applicable to Mutual of America and the Teachers Insurance Annuity Association and treats them for tax purposes as life insurance companies. However, the companies are granted a fresh start with respect to accounting method changes

caused by the 1997 repeal. Thus, no adjustment under Code Sec. 481 will be required for the change in its method of accounting for the first tax year beginning after December 31, 1997. For purposes of determining gain or loss, the adjusted basis of any asset held by the affected company on the first day of the tax year is treated as equal to the fair market value of the asset as of such date. Moreover, any reserve weakening after June 8, 1997, by one of the affected companies is to be treated as occurring in the organization's first tax year beginning after December 31, 1997.

Regulations for short tax year issues. The IRS may prescribe rules for determining proper adjustments for the affected companies with respect to short tax years which begin under Code Sec. 843 as a result of the change made by this provision.

Effective date. The provision applies to tax years beginning after December 31, 1997.

Act Sec. 1042(a), amending Act Sec. 1012(c)(4) of the Tax Reform Act of 1986; Act Sec. 1042(b)-(d). Law at ¶ 7028. Committee Report at ¶ 11,340.

UNRELATED BUSINESS INCOME TAX

Sponsorship Payments

¶ 611

Background

Prior to the Taxpayer Relief Act of 1997, the IRS had taken the position that, under certain circumstances, sponsorship payments received by a tax-exempt organization could be subject to the unrelated business income tax (UBIT). Basically, the IRS position was that funds received by the tax-exempt organization for institutional or goodwill advertising was not subject to the UBIT. However, funds received for specific product advertising was subject to the UBIT (Prop. Reg. § 1.513-4 and IRS Announcement 92-15, I.R.B. 1992-5, 51).

Qualified sponsorship payments are exempt from UBIT.—Certain qualified sponsorship payments solicited and received by a tax-exempt organization are not subject to the UBIT. This new provision reduces some of the uncertainty that existed under the facts and circumstances test that had been used by the IRS (e.g., IRS Announcement 92-15) when it determined how such payments should be classified.

"Qualified sponsorship payment" defined. The term "qualified sponsorship payment" is any payment to a tax-exempt organization by a payor engaged in a trade or business that does not expect any substantial return benefit—other than the use or acknowledgment of the payor's name, logo, or product lines in connection with the activities of the tax-exempt organization. In addition, there must not be any arrangement between the payor and the tax-exempt organization under which the payor will receive any substantial return benefit.

> **Example (1).** Advet Inc., a manufacturer of pet food, contributes $10,000 to a tax-exempt organization that cares for abandoned cats and dogs. In return for the contribution, the tax-exempt organization agrees to carry Advet's corporate logo on its monthly newsletter that it mails to contributors.

Based upon these facts, the $10,000 would not be subject to the UBIT because Advet will not obtain any substantial return benefit for its contribution.

PRACTICAL ANALYSIS. Bruce Hopkins, of counsel to Polsinelli, White, Vardeman & Shalton, Kansas City, Missouri, comments that there is a lot of history behind this. Years ago, the IRS tried to tax a payment from Mobil Oil to the Cotton Bowl Association. The Cotton Bowl wanted to treat it as a contribution, while the IRS said it was unrelated business taxable income (UBTI) paid for advertising services. This generated a tremendous amount of controversy over how far a charity can go in recognizing and thanking a donor, and still have a payment classified as a gift.

The new law creates a "qualified sponsorship payment." If qualified, then it is not UBTI. What they have done is to draw a line regarding how much a charity can say about a donor without converting a payment into UBTI. This is the single most important provision in the new law for nonprofits that do any kind of fundraising.

Advertising may be subject to UBIT. A "qualified sponsorship payment" does not include advertising of the payor's products or services. In this context, "advertising" includes messages that contain qualitative or comparative language, price information, an endorsement, or an inducement to purchase, sell, or use the payor's products and services.

Example (2). Assume the same facts as in Example (1), above, except that the tax-exempt organization also agrees to place its endorsement of Advet's pet food in its monthly newsletter. The endorsement will state that the tax-exempt organization only feeds Advet's pet foods to the animals in its charge because of the superior quality of the products. Based upon these facts, the $10,000 payment made by Advet would not qualify as a sponsorship payment. However, it is possible that a portion of the payment might qualify (see, "Allocation of payments," below).

Allocation of payments. When a payor makes a single payment to a tax-exempt organization and a portion of the payment would have qualified as a qualified sponsorship payment if it had been made separately, the payment must be allocated between the nonqualified amount and the qualified amount.

Planning Note. According to the House Committee Report, the portion of the payment that is equal to the fair market value of the benefit (e.g., advertising) provided by the tax-exempt organization is subject to the UBIT.

Example (3). Assume the same facts as in Example (2), above. In addition, assume that it is determined that Advet received the benefit of $1,000 in advertising because of the endorsement of its products by the tax-exempt organization. Based on these facts, $1,000 would be subject to the UBIT and $9,000 would be classified as a qualified sponsorship payment.

Contingent payments. A "qualified sponsorship payment" does not include any payment if the amount of the payment is contingent upon:

(1) the level of attendance at one or more events;

(2) broadcast ratings; or

(3) other factors indicating the degree of public exposure to one or more events.

Planning Note. The House Committee Report sets forth the rule that the mere fact that the payment is based upon the event actually taking place or being broadcast, does not necessarily cause the payment to be subject to the UBIT. In addition, the mere distribution or display of the payor's products to the general public at a sponsored event will not necessarily make the payment subject to the UBIT. Generally, the display or distribution of the products will not be considered advertising. It does not matter whether the products are given away free or sold at the event.

Acknowledgments or advertising in periodicals. A "qualified sponsorship payment" does not include any payment that entitles the payor to an acknowledgment or advertising in regularly scheduled and printed material published by or on behalf of the tax-exempt organization. However, if the publication is related to, and primarily distributed in connection with, a specific event conducted by the tax-exempt organization, the payment may be a qualified sponsorship payment.

Example (4). Parka Inc., a manufacturer of outdoor clothing, contributes $5,000 to Save the Wolves Foundation, a tax-exempt organization. In return for the $5,000, an ad for Parka's products will run in the foundation's monthly magazine. Under these facts, no portion of the $5,000 payment could be excluded from the foundation's income subject to UBIT.

Example (5). Assume the same facts as in Example (4), above, except that the $5,000 payment will entitle Parka Inc. to be acknowledged in a publication distributed by the foundation at its annual Wolf Day celebration at Yellowstone National Park. Based on these facts, the $5,000 payment would be considered a qualified sponsorship payment and not subject to UBIT.

Qualified trade show activities. A "qualified sponsorship payment" does not include any payment made in connection with a "qualified convention or trade show activity." The term "qualified convention or trade show activity" is defined by Code Sec. 513(d)(3)(B) and generally refers to conventions or trade shows conducted by certain tax-exempt organizations that have as one of their purposes the promotion of interest in the products and services of the industry in general or the purpose to educate the attendees regarding new developments or products and services related to the exempt activities of the organization.

Providing services or other privileges to the sponsor. If, in connection with a sponsorship payment, the tax-exempt organization provides services, facilities, or other privileges to a sponsor or the sponsor's designee, the furnishing of these privileges, according to the House Committee Report, will not have any bearing on the determination of whether the payment is a qualified sponsorship payment. Examples of privileges that the tax-exempt organization might provide include complimentary tickets, or receptions for major donors.

However, the providing of privileges to the sponsor will be evaluated as a separate transaction in determining whether the tax-exempt organization hasunrelated business taxable income from the event. Generally, if the privileges do not provide substantial return benefits or if the providing of such privileges is a related business activity, then the payments related to such privileges will not be subject to UBIT.

Sponsor's receipt of a license. Also, according to the House Committee Report, when a sponsor receives a license to use an intangible asset of the tax-exempt organization (e.g., logo, trademark, or designation), the receipt of the license will be treated as separate from the qualified sponsorship transaction in determining if the tax-exempt organization is subject to UBIT.

Caution. The rules concerning the providing of privileges to the sponsor and the sponsor's receipt of a license are not contained in the Code. Instead, they are contained in the legislative history of this provision. However, it is likely that the same rules will be set forth in future IRS regulations.

Planning Note. This new provision concerning qualified sponsorship payments is in addition to the other exceptions that already exist regarding UBIT (e.g., the exceptions for activities for which substantially all the work is performed by volunteers and for activities that are not regularly carried on). In addition, the House Committee Report states that by enacting this new provision, no inference is made concerning the tax treatment of sponsorship payments made prior to 1998.

Effective date. The provision applies to payments solicited or received after December 31, 1997.

Act Sec. 965(a), adding new Code Sec. 513(i); Act Sec. 965(b). Law at ¶ 5175. Committee Report at ¶ 10,855.

Income from Subsidiaries

¶ 613

Background

Rent, royalty, annuity and interest payments received by a tax-exempt organization may be subject to the unrelated business income tax (UBIT) under Code Sec. 512(b)(13). Prior to the Taxpayer Relief Act of 1997, these payments were subject to the UBIT if they were received from a taxable or tax-exempt subsidiary that was 80 percent controlled, as defined under Code Sec. 368(c), by the parent. The Code Sec. 512(b)(13) control test also did not include any indirect ownership rules. Thus, rent, royalty, annuity and interest payments received by tax-exempt parent organizations from second-tier subsidiaries were generally not subject to the UBIT.

Unrelated business income look-through rules expanded.—In order to make it more difficult for tax-exempt organizations to avoid unrelated business taxable income (UBTI) treatment of amounts received from their subsidiaries, the definition of "control" under Code Sec. 512(b)(13) has been modified. The threshold for control of a subsidiary, which triggers UBTI, is lowered from 80 percent to more than 50 percent.

Control of a stock subsidiary means ownership by vote or value of more than 50 percent of the stock. For a partnership or other entity, control means ownership of more than 50 percent of the profits, capital or beneficial interests. Prior to the Act, control of a stock subsidiary required the parent organization to own 80 percent or more of the voting stock and all other classes of stock of the subsidiary. Thus, prior to the Act, tax-exempt organizations could issue 21 percent of nonvoting stock with nominal value and not be deemed "controlled."

PRACTICAL ANALYSIS. Bruce Hopkins, of counsel to Polsinelli, White, Vardeman & Shalton, Kansas City, Missouri, warns that the Taxpayer Relief Act of 1997 redefines what it takes to have a subsidiary for UBTI purposes. Before, 80 percent or more of the subsidiary had to be owned by the exempt organization for the subsidiary to be deemed controlled. Now, more than 50 percent will satisfy the control test. This will make it much easier for the government to make a case of parent-subsidiary relationship. It will have a big impact on many organizations, particularly in the health care field. The only way to avoid the impact of this provision is to have a minority position. You cannot have it both ways—you cannot control the subsidiary and still avoid tax.

Constructive ownership. The constructive ownership rules of Code Sec. 318 are extended to apply to Code Sec. 512(b)(13). Therefore, a parent tax-exempt organization is deemed to control any subsidiary in which it holds more than 50 percent, directly or indirectly, of the voting power or value.

Receipt by a controlled entity. The amount of an annuity, interest, rent, or royalty payment made by a controlled entity to a tax-exempt organization is UBTI to the extent the payment reduces the net unrelated income, or increases the net loss, of the controlled entity.

PRACTICAL ANALYSIS. Bruce Hopkins, of counsel to Polsinelli, White, Vardeman & Shalton, Kansas City, Missouri, notes that rents, royalties, etc., from second-tier subsidiaries in the past did not constitute unrelated business income to the parent. Under the new law, this is changed. It makes certain constructive ownership rules apply, so that the second-tier subsidiary is now deemed indirectly controlled by the parent, and the revenue will be taxed.

Planning Note. Code Sec. 512(b)(13) does not tax interest, rent, or royalty payments from unrelated entities. Therefore, it may be advantageous to structure a transaction so that these same payments are received from an unrelated entity instead of a subsidiary.

PRACTICAL ANALYSIS. Robert A. Boisture, of Caplin & Drysdale, Washington, D.C., notes that the Act contains a number of provisions affecting exempt organizations and their donors, including several of broad significance. Among these, the Act significantly tightens the definition of a controlled subsidiary for purposes of the unrelated business income tax that taxes an exempt organization on interest, rents, and royalties from such subsidiaries engaged in unrelated business activities. Various structures, including the use of second-tier subsidiaries, that effectively avoided tax under prior law, will no longer achieve this result and will need to be reviewed.

The Act also establishes detailed rules for the UBIT treatment of corporate sponsorship payments received by exempt organizations (see ¶ 611). These rules clarify the extent to which an exempt

organization can acknowledge payments by corporate sponsors without being deemed to have made a taxable sale of advertising. The generally favorable rules largely track the proposed regulations issued by the IRS in 1993, but, quite significantly, delete the regulation's "tainting rule" under which otherwise nontaxable sponsorship payments would have been fully taxable if the exempt organization provided even relatively minor advertising services. Organizations should note that the new rules do not protect corporate sponsorship payments received in return for acknowledgements in regularly published periodicals or in connection with conventions and trade shows.

For donors, the Act extends through June 30, 1998, the tax law provision that allows persons contributing appreciated publicly traded stock to private foundations to deduct the stock's full fair market value rather than their basis (see ¶ 105). On the other hand, the new law also includes new restrictions on charitable remainder trusts designed to ensure that the present value of the charitable remainder equals no less than 10 percent of the value of the contribution to the trust (see ¶ 281).

Effective date. The modification of the control test to one based on vote or value, the application of the constructive ownership rules under Code Sec. 318, the reduction in ownership threshold, and the modifications to the flow-through method apply to tax years beginning after August 5, 1997. However, the above changes do not apply to any payment made during the first two tax years beginning on or after August 5, 1997, if the payment is made pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before the payment.

Act Sec. 1041(a), amending Code Sec. 512(b)(13); Act Sec. 1041(b). Law at ¶ 5173. Committee Report at ¶ 11,335.

HOMEOWNERS ASSOCIATIONS

Holders of Timeshare Interests

¶ 616

Background

Under prior law, timeshare associations could not elect to be taxed as homeowners associations because they could not meet the Code Sec. 528 requirement, under the regulations, that the units be used for residential purposes. In addition, timeshare associations could not qualify for the election because they perform a relatively large amount of services for their owners.

The IRS, in Letter Ruling 9539001, has ruled that refunds of excess assessments, special assessments held in a segregated account, and capital assessments held as contributions to capital are taxable as income to timeshare associations.

Homeowner association rules extended to timeshare associations.—Qualifying timeshare associations may elect to be taxed under Code Sec. 528 at a rate of 32 percent on their "timeshare association income." Electing associations

would be treated similarly to homeowners associations, except at a higher tax rate (homeowners associations are taxed at a 30-percent rate).

Code Sec. 528 qualifications. To qualify under Code Sec. 528, the timeshare association must meet all of the following conditions:

(1) It must receive at least 60 percent of its gross income from membership dues, fees, or assessments from owners of either (a) timeshare rights to use or (b) timeshare ownership in timeshare association property.

(2) At least 90 percent of its expenditures for the tax year must be for the acquisition, management, maintenance, or care of association property and activities provided by the association to, or on behalf of, members of the timeshare association. The House Committee Report explains that "activities provided to, or on behalf of, members of the [timeshare] association" include events located on association property, such as golf lessons on the association's golf range and parties at the association's swimming pool.

(3) No part of the net earnings of the association may inure to the benefit of any private shareholder or individual.

Example. Brittany Place, a timeshare association, holds member meetings in a meeting room on the association's property. This would be considered an activity provided to, or on behalf of, members of the association.

A member of a qualified timeshare association must hold a timeshare right to use, or timeshare ownership in, real property of the association. Property of a timeshare association includes rights arising out of easements and covenants related to the timeshare project.

Planning Note. If the election is made, tax will not be imposed on the timeshare association's capital reserves, refunds of excess assessments, and prepaid assessments.

Effective date. The provision is effective for tax years beginning after December 31, 1996.

Act Sec. 966(a)(1), amending Code Sec. 528(c)(1); Act Sec. 966(a)(2), amending Code Sec. 528(c); Act Sec. 966(b), amending Code Sec. 528(d)(3); Act Sec. 966(c), amending Code Sec. 528(c)(5) (as redesignated by Act Sec. 966(a)(2)); Act Sec. 966(d), amending Code Sec. 528(b); Act Sec. 966(e). Law at ¶ 5177. Committee Report at ¶ 10,860.

INTERMEDIATE SANCTIONS

Reasonable Cause Abatement

¶ 619

Background

The Taxpayer Bill of Rights 2 of 1996 (TBOR2) (P.L. 104-168) added Code Sec. 4958, which provides for the imposition of penalty excise taxes as an intermediate sanction when a Code Sec. 501(c)(3) or Code Sec. 501(c)(4) organization engages in an "excess benefit transaction." These excise taxes are imposed on "disqualified persons" who improperly benefit from the transactions and on organization managers who knowingly participate in the transactions. Private foundations are not subject to these sanctions, but are subject to another penalty regime.

Background

A disqualified person who benefits from an excess benefit transaction is subject to a first-tier penalty equal to 25 percent of the excess benefit. Organization managers who participate in an excess benefit transaction, knowing that it is improper, are subject to a first-tier penalty tax of 10 percent of the amount of the excess benefit (to a maximum of $10,000).

When the provision was added, failure to cross-reference subchapter D in Code Sec. 4962 left the IRS without the authority to abate Code Sec. 4958 excise taxes, despite Congress's stated intent to give the IRS such authority.

Prior to enactment of the Taxpayer Relief Act of 1997, the first-tier taxes that could be abated included some related to private foundations, such as those provided for in Code Sec. 4941 (taxes on self-dealing), Code Sec. 4942 (taxes on failure to distribute income), and Code Sec. 4943 (taxes on excess business holdings). Additionally, the IRS could abate taxes on political expenditures of Code Sec. 501(c)(3) organizations.

Reasonable cause abatement for first-tier intermediate sanctions excise tax.—A technical correction is made to provide the IRS with the authority to abate first-tier taxes on excess benefit transactions (Code Sec. 4958) if the taxable event was due to reasonable cause, and not to willful neglect, and if the event was corrected within the applicable correction period. Exempt organizations listed under Code Sec. 501(c)(3) or Code Sec. 501(c)(4) are subject to the taxes on excess benefit transactions.

Organizations subject to penalty on excess benefit transactions. Code Sec. 501(c)(3) lists nonprofit, nonpolitical organizations operated exclusively (1) for religious, charitable, scientific, public safety, literary or educational purposes; (2) to foster national or international amateur sports competition, but only if no part of its activities involve the provision of athletic facilities or equipment; or (3) for the prevention of cruelty to children or animals.

Organizations included under Code Sec. 501(c)(4) are (1) not-for-profit civic leagues or organizations operated exclusively for the promotion of social welfare and (2) local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational or recreational purposes.

Effective date. The IRS abatement authority for the excise tax applies to excess benefit transactions that occur on or after September 14, 1995. However, the provision does not apply to any benefits arising out of a transaction pursuant to any written contract that was binding on September 13, 1995, and at all times thereafter before the transaction occurred.

Act Sec. 1603(a), amending Code Sec. 4962(b). Law at ¶ 5523. Committee Report at ¶ 13,915.

Reporting of Penalties

¶ 621

Background

A Code Sec. 501(c)(3) organization is required to report annually on Form 990 the amounts of certain excise tax penalties paid by the organization. Penalties are

Background ____

imposed as intermediate sanctions in cases where certain tax-exempt organizations engage in prohibited transactions. For example, a penalty is imposed on a public charity for making excess lobbying expenditures (Code Sec. 4911). Other penalty taxes, such as the following, are imposed not only on the affected organization, but also on organization managers who agree to an expenditure knowing that it is improper: (1) a tax on certain public charities that make disqualifying lobbying expenditures (Code Sec. 4912) and (2) a tax on political expenditures of Code Sec. 501(c)(3) organizations (Code Sec. 4955). Although Code Sec. 4912 and Code Sec. 4955 impose excise taxes on organization managers, an organization was not required under prior law to report any of these penalties paid by organization managers.

In addition, a Code Sec. 501(c)(3) organization must report on Form 990 any amount of excise tax on excess benefit transactions paid by the organization, or any disqualified person with respect to such organization (Code Sec. 4958). However, under prior law, there was no explicit reporting requirement for taxes paid by an organization manager solely in that capacity, although an organization manager might also be considered a disqualified person with respect to an excess benefit transaction, in which case the penalty was required to be reported. Further, there was no requirement that reimbursements of the above taxes paid by the organization to its manager had to be reported.

In the event that a first-tier penalty excise tax imposed under Code Sec. 4955 or Code Sec. 4958 was abated by the IRS, it was not clear under prior law whether the organization was required to report the abated penalty.

New reporting requirements for tax-exempt organizations.—Tax-exempt organizations' reporting requirements have been made consistent with the excise tax penalty provisions to which they relate.

Now, Code Sec. 501(c)(3) organizations are required to report annually on Form 990 any amounts paid under Code Sec. 4911, Code Sec. 4912 and Code Sec. 4955 by the organization or by organization managers. A Code Sec. 501(c)(3) organization must also report on Form 990 any amount of excise tax on excess benefit transactions paid by the organization, organization manager or any disqualified person with respect to such organization, during the tax year.

Any reimbursements paid by an organization to the organization manager with respect to any of the above penalty taxes must also be reported.

Further, the IRS has the authority to abate certain first-tier taxes under Code Sec. 4962 if the taxable event was due to reasonable cause and not to willful neglect, and the event was corrected within the applicable correction period. No reporting is required, under Code Sec. 6033(b), in the event a first-tier penalty excise tax imposed under Code Sec. 4955 or Code Sec. 4958 is abated by the IRS.

Effective date. These amendments apply to returns for tax years beginning after July 30, 1996.

Act Sec. 1603(b), amending Code Sec. 6033(b)(10) and Code Sec. 6033(b)(11); Act Sec. 1603(c). Law at ¶ 5583. Committee Report at ¶ 13,920.

ESTIMATED TAX

Estimated Tax Payments by Private Foundations

¶ 623

Background

Tax-exempt private foundations are required to pay an excise tax of two percent of their net investment income for the tax year. Under prior law, the due date for a calender-year private foundation's first-quarter estimated tax payment for this excise tax liability or unrelated business income tax liability was April 15. Similarly, fiscal-year foundations were required to make their first-quarter estimated tax payments no later than the 15th day of the fourth month of their tax year.

Extension of the due date for first-quarter estimated tax payments by private foundations.—The due date for a calender-year private foundation's first-quarter estimated tax payment for excise tax liability on net investment income or unrelated business income tax liability has been extended from April 15 to May 15. Similarly, fiscal-year foundations are now required to make their first-quarter estimated tax payments no later than the 15th day of the fifth month of their tax year.

Planning Note. The new due date coincides with the due date for Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation. This should enable a private foundation to more accurately calculate estimated tax payments because such payments are determined partially by reference to its tax liability for the preceding year.

Effective date. The provision applies for purposes of determining underpayments of estimated tax for tax years beginning after August 5, 1997.

Act Sec. 1461(a), amending Code Sec. 6655(g)(3); Act Sec. 1461(b). Law at ¶ 5695. Committee Report at ¶ 13,115.

Chapter 7

Pensions and Qualified Plans

QUALIFIED PLANS GENERALLY

Rollovers from Qualified Plans

¶ 701

Background

IRS regulations (§ 1.401(a)(31)-1, Q&A-13(b)) provide that a qualified retirement plan that accepts rollover contributions from another retirement plan will not be disqualified in the event that the plan making the distribution is not qualified at the time of the distribution so long as the recipient plan "reasonably conclude[s]," prior to accepting the distribution, that the distributing plan is

Background

qualified. The regulations specify that a recipient plan can reasonably conclude that a distributing plan is qualified if, for example, the distributing plan provides a statement that it has received a favorable determination letter from the IRS.

The Senate Finance Committee report indicated that despite this regulatory guidance, there was a need for further guidance on the issue of when a recipient plan can reasonably conclude that the distributing plan is qualified.

Clarification of disqualification rules relating to acceptance of rollover contributions.—The Act directs the Secretary of the Treasury or his delegate to clarify that, in the case of a rollover contribution to a pension plan, it is not necessary for the distributing plan to have a determination letter from the IRS.

Under prior law, there was some ambiguity as to when recipient plans were protected from the possibility of losing their qualified status when accepting rollover contributions from other plans. IRS regulations (§ 1.401(a)(31)-1, Q&A-13(b)) provide that the recipient plan is protected from loss of qualified status so long as it can "reasonably conclude" that the plan making the distribution is qualified. The regulations specify that a recipient plan can reasonably conclude that a distributing plan is qualified if, for example, the distributing plan provides a statement that it has received a favorable determination letter from the IRS.

Under the Act, the Secretary of the Treasury or his delegate must issue guidance with respect to the IRS regulations that will clarify that it is not necessary for the distributing plan to have a determination letter with respect to its qualified status in order for the recipient plan to reasonably conclude that the contribution is a valid rollover contribution.

Effective date. The provision is effective on August 5, 1997. However, according to the Conference Committee Report, the provision is effective for rollover contributions made after 1997.

Act Sec. 1509. Law at ¶ 7058. Committee Report at ¶ 13,295.

Assignment or Alienation

¶ 703

Background

Neither ERISA nor the Code specifically permitted the assignment or alienation of retirement plan benefits in the case of participants who breached their fiduciary duty to the plans or who committed criminal acts with respect to the plans. In the absence of statutory guidance, courts were split on the issue of whether the benefits of such a participant could be offset against the amount owed by him or her to the plan as a result of the fiduciary breach or criminal act.

Modification of prohibition of assignment or alienation of plan benefits for participants committing fiduciary breach.—Under a limited exception to the anti-alienation rules governing retirement plans, a participant's benefits under an employee pension plan may be reduced where the participant has committed a breach of fiduciary duty to the plan or committed a criminal act against the plan.

The Act provides that a participant's benefits may be reduced if a court order or requirement to pay arises from: (1) a judgment of conviction for a crime involving the plan; (2) a civil judgment (or consent order or decree) that is entered by a court in an action brought in connection with a breach (or alleged breach) of fiduciary duty under ERISA; or (3) a settlement agreement entered into by the participant and either the Secretary of Labor or the Pension Benefit Guaranty Corporation in connection with a breach of fiduciary duty under ERISA by a fiduciary or any other person.

The court order, judgment, decree, or settlement agreement must specifically require that all or part of the amount to be paid to the plan be offset against the participant's plan benefits.

Spousal consent. If the survivor annuity requirements of ERISA Sec. 205 (or Code Sec. 401(a)(11)) apply to distributions under the plan to the participant and if the participant is married at the time his or her benefits under the plan are offset, one of the following three conditions must be satisfied:

> (1) Spousal consent must be obtained (or an alternative described below must be satisfied) or the spouse must have waived his or her rights to a qualified joint and survivor annuity or a qualified preretirement survivor annuity. The spousal consent requirement is satisfied if the consent is in writing and is witnessed by a notary public or plan representative.
>
> If spousal consent cannot be obtained, an alternative requirement may be satisfied. Under this alternative, it must be established to the satisfaction of a plan representative that spousal consent cannot be obtained because there is no spouse, because the spouse cannot be located, or because of other circumstances that may be prescribed in Treasury regulations.
>
> (2) The spouse is also required to pay an amount to the plan in the judgment, order, decree or settlement in connection with a breach of fiduciary duty.
>
> (3) In the judgment, order, decree or settlement, the spouse is provided with a survivor annuity under a qualified joint and survivor annuity and under a qualified preretirement survivor annuity. The survivor annuity must be determined as if: (a) the participant terminated employment on the offset date, (b) there was no offset, (c) the plan allowed benefits to begin only on or after normal retirement age, (d) the plan provided only the minimum required qualified joint and survivor annuity, and (e) the amount of the qualified preretirement survivor annuity is equal to the amount of the survivor annuity payable under the minimum-required qualified joint and survivor annuity.
>
> The minimum-required qualified joint and survivor annuity is a qualified joint and survivor annuity that is the actuarial equivalent of the participant's accrued benefit and under which the survivor annuity is 50 percent of the amount of the annuity that is payable during the joint lives of the participant and the spouse.

Inclusion in income. According to the Conference Committee Report, the offset is includible in income on the date of the offset.

Effective date. The provision applies to judgments, orders, and decrees issued, and settlement agreements entered into, on, or after August 5, 1997.

Act Sec. 1502(a), adding ERISA Sec. 206(d)(4) and (5); Act Sec. 1502(b), adding Code Sec. 401(a)(13)(C) and (D); Act Sec. 1502(c). Law at ¶ 5131 and 7046. Committee Report at ¶ 13,225.

Involuntary Cash-Outs

¶ 706

Background

Prior to the Act, a qualified plan could involuntarily pay out the balance of a participant's account without the participant's (or the participant's spouse's) consent if the present value of the benefit did not exceed $3,500.

Cash-out of $5,000 benefit.—A qualified plan can pay the balance of a participant's account without the participant's (or the participant's spouse's) consent if the present value of the benefit does not exceed $5,000. Previously, the limit was set at $3,500.

If a benefit is cashed out and the participant subsequently returns to work for the employer, the plan is not required to restore the participant's previous service unless the participant reimburses the plan for the cashed out amount.

> **Example (1).** Joe has worked for Acme Corp. for four years and participated in Acme's defined benefit plan during the second year, when he became eligible to participate. Acme decides to let Joe go. The present value of Joe's benefit is $4,000. The plan pays Joe the $4,000 without consulting him about whether he wanted to leave the amount in the plan.

> **Example (2).** Assume the same facts as above except that two years later Acme asks Joe to return to work. Acme would not need to restore the prior four years of service to Joe unless Joe repaid $4,000 to the plan.

Effective date. The $5,000 cash-out limit applies to plan years beginning after August 5, 1997.

Act Sec. 1071(a)(1), amending Code Sec. 411(a)(11)(A); Act Sec. 1071(a)(2)(A), amending Code Secs. 411(a)(7)(B), 417(e)(1) and (2), and Code Sec. 457(e)(9)(A); Act Sec. 1071(b)(1), amending ERISA Sec. 203(e)(1); Act Sec. 1071(b)(2), amending ERISA Secs. 204(d)(1) and 205(g)(1) and (2); Act Sec. 1071(c). Law at ¶ 5147, 5155, and 7031. Committee Report at ¶ 11,445.

Summary Plan Descriptions

¶ 708

Background

Under prior law, administrators of employee benefit plans subject to the reporting and disclosure requirements of ERISA were required to provide to the Secretary of Labor summary plan descriptions within 120 days after becoming subject to those requirements. They were also required to provide updated plan descriptions no more frequently than once every five years, and summaries of material modifications (or revised summary plan descriptions) to such plans within 210 days after the plan year in which the changes were adopted. The Act

Background

eliminates these requirements and instead requires plan administrators to provide these and related documents to the Secretary only upon request.

Elimination of paperwork burdens on plans.—The Act eliminates the requirement that administrators of employee benefit plans subject to the reporting and disclosure requirements of ERISA must file summary plan descriptions (SPDs), separate plan descriptions with certain prescribed information, and summaries of material modifications (SMMs) to the plans with the Secretary of Labor. However, SPDs and SMMs (as well as any other documents relating to the plans) must be provided to the Secretary of Labor upon request. If these documents are not provided within 30 days of the request, the Secretary may assess a civil penalty of up to $100 per day (up to $1,000 per request). No penalty is imposed for any failure to provide the requested material if the failure results from matters reasonably beyond the plan administrator's control.

Effective date. These provisions are effective on August 5, 1997.

Act Sec. 1503(a), amending ERISA Sec. 101(b); Act Sec. 1503(b)(1), amending ERISA Sec. 102(a); Act Sec. 1503(b)(2)(A), amending ERISA Sec. 102(b); Act Sec. 1503(b)(2)(B), amending the heading of ERISA Sec. 102; Act Sec. 1503(c)(1), amending ERISA Sec. 104(a)(1); Act Sec. 1503(c)(2)(A), adding ERISA Sec. 104(a)(6); Act Sec. 1503(c)(2)(B), amending ERISA Sec. 502(c); Act Sec. 1503(d)(1), amending ERISA Sec. 104(b)(1); Act Sec. 1503(d)(2), amending ERISA Sec. 104(b)(2); Act Sec. 1503(d)(3), amending ERISA Sec. 104(b)(4); Act Sec. 1503(d)(4), amending ERISA Sec. 106(a); Act Sec. 1503(d)(5), amending ERISA Sec. 107; Act Sec. 1503(d)(6), amending ERISA Sec. 108(2)(B); Act Sec. 1503(d)(7), amending ERISA Sec. 502(a)(6); Act Sec. 1503(e), amending Social Security Act Sec. 1144(c). Law at ¶ 7049. Committee Report at ¶ 13,235.

Paperless Compliance Guidelines

¶ 710

Background

The extent to which new technologies can be used to satisfy the various notice, consent, election, disclosure and record-keeping requirements under the Code and ERISA is unclear.

New technologies in retirement plans.—The Act provides that the Secretary of Treasury and Secretary of Labor will each issue guidance that is designed to interpret the notice, election, consent, disclosure and time requirements (and related record-keeping requirements) under the Code and ERISA relating to retirement plans as applied to the use of new technologies (e.g., e-mail, voice response systems, computers) by plan sponsors and administrators while maintaining the protection of the rights of participants and beneficiaries. Guidance will also be issued to clarify the extent to which writing requirements under the Code relating to retirement plans will be interpreted to permit paperless transactions.

PRACTICAL ANALYSIS. Fred Reish of Reish & Luftman, Los Angeles, points out that the legislative call in Act Sec. 1510 for regulations on paperless plan administration makes no specific

change to Title I or Title II of ERISA. However, it is an acknowledgement by Congress and the Administration that the law needs to evolve to take into account a shift from a paper-based society to a largely paperless environment. Presumably, the immediate beneficiaries of this evolution will be financial institutions involved in providing investment products and services to plans and large employers with the hardware and software capacity to support paperless administration.

Effective date. The provision is effective on August 5, 1997 and requires that the guidance be issued not later than December 31, 1998. The Act further provides that final regulations applicable to such guidance will not be effective until the first plan year beginning at least six months after the issuance of final regulations.

Act Sec. 1510. Law at ¶ 7061. Committee Report at ¶ 13,315.

Prohibited Transactions Tax

¶ 712

Background

A two-tier tax is imposed on transactions between a qualified plan and persons with a close relationship to that plan to prevent them from using that relationship to the detriment of plan participants and beneficiaries. Under prior law, the first-tier tax was a 10-percent penalty tax on the amount involved in a prohibited transaction. If not corrected within a specified period, the tax increases to 100 percent of the amount involved.

Prohibited transaction excise taxes.—The Act increases the initial level excise tax on prohibited transactions from 10 percent to 15 percent. No other changes are made to prohibited transaction rules so the 100-percent excise tax continues to apply if the prohibited transaction is not corrected within the specified time limit.

Effective date. Effective with respect to prohibited transactions occurring after August 5, 1997.

Act Sec. 1074(a), amending Code Sec. 4975(a); Act Sec. 1074(b). Law at ¶ 5529. Committee Report at ¶ 11,475.

Excess Distribution Tax

¶ 714

Background

Under prior law, a 15 percent excise tax was imposed on excess distributions from qualified retirement plans, tax-sheltered annuities, and IRAs. Excess distributions were generally the aggregate amount of retirement distributions from the three types of plans during any calendar year in excess of $160,000 (as adjusted for inflation in 1997) or five times that amount in the case of a lump-sum distribution. This tax did not apply for the years 1997-1999.

An additional 15 percent estate tax was imposed on an individual's excess retirement accumulations. These accumulations were composed of the balance in

Background

retirement plans in excess of the present value of a benefit that would not have been subject to the 15 percent tax on distributions.

Repeal of excess distribution tax.—The law repeals both the 15-percent excise tax on excess distributions from qualified retirement plans, tax-sheltered annuities, and IRAs and the 15-percent excise tax on excess retirement accumulations. An excess distribution would be one that exceeded $160,000 or five times that amount in the case of a lump-sum distribution.

PRACTICAL ANALYSIS. Bruce Ashton of Reish & Luftman, Los Angeles, notes that the Code Sec. 4980A taxes on excess lifetime distributions and excess accumulations at death (the so-called "success tax") penalized not only large benefit accruals but also the successful investment of plan assets in defined contribution plans and IRAs. The repeal of these 15 percent add-on taxes should encourage larger benefit accumulations for participants in all types of qualified plans, 403(a) and 403(b) annuity plans, and individual retirement accounts and annuities.

In addition, for large benefit accumulations the emphasis will shift from distribution planning to minimize the impact of the Code Sec. 4980A taxes to planning for maximizing the time period over which benefits are distributed (and thus the tax-deferred compounding). Finally, the elimination of Code Sec. 4980A, coupled with the repeal last year of Code Sec. 415(e) (effective for limitation years beginning after December 31, 2000), will stimulate the adoption of defined benefit plans by small employers. For larger employers, the change may result in improved benefits for rank-and-file employees, since larger benefits can be provided by "richer" qualified plans and, therefore, there will be less incentive to provide benefits in nonqualified plans for company executives.

Effective dates. Repeal of the excess distribution tax applies to excess distributions received after December 31, 1996. The repeal of the excess accumulation tax applies to estates of decedents dying after December 31, 1996.

Act Sec. 1073(a), repealing Code Sec. 4980A; Act Sec. 1073(b), amending Code Sec. 691(c)(1) by striking subparagraph (C), Code Sec. 2013 by striking subsection (g), Code Sec. 2053(c)(1)(B) by striking the last sentence, Code Sec. 6018(a) by striking paragraph (4); Act Sec. 1073(c). Law at ¶ 5535. Committee Report at ¶ 11,465.

DEFINED BENEFIT PLANS

Full Funding Limitation

¶ 717

Background

The full funding limit for defined benefit pension plans is calculated in part by determining the lesser of a plan's accrued liability and a percentage limit of current liability. Under prior law, this percentage limit was 150 percent.

Increase in current liability funding limit.—The Act increases the full funding percentage limit for defined benefit pension plans from 150 percent to the following:

155% for plan years beginning in 1999 or 2000;

160% for plan years beginning in 2001 or 2002;

165% for plan years beginning in 2003 and 2004; and

170% for plan years beginning in 2005 and later.

According to the Senate Finance Committee Report, the percentage limit was increased because the Committee believed the percentage limit of 150 percent "unduly restrict[ed] funding."

PRACTICAL ANALYSIS. Bruce Ashton of Reish & Luftman, Los Angeles, notes that the change in the 1987 Revenue Act full funding limit (in Act Sec. 1521) will have little impact on the vast majority of defined benefit pension plans, since most were not limited under the existing 150 percent limitation. The primary effects of the 150 percent of current liability limitation have been to (1) cause wide swings in funding from year to year and (2) prevent some plans, which were underfunded for projected liabilities, from making a deductible contribution. The amendment to Code Sec. 412(c)(7), which gradually increases the percentage limitation, will not eliminate the peaks and valleys in funding, but it will help in levelling out the funding, resulting in greater predictability and better benefit management.

Effective date. The provision applies to plan years beginning after 1998.

Act Sec. 1521(a), amending Code Sec. 412(c)(7); Act Sec. 1521(b), amending ERISA Sec. 302(c)(7); Act Sec. 1521(d)(1). Law at ¶ 5149 and 7064. Committee Report at ¶ 13,335.

¶ 719

Background

Under prior law, amounts that could not be contributed to a defined benefit pension plan due to the current liability full funding limit were amortized over 10 years.

Amortization rule for amounts that cannot be contributed.—Under the Act, amounts that cannot be contributed to a defined benefit pension plan due to the current liability full funding limit are amortized over 20 years. Specifically, contributions that would be required to be made to a defined benefit plan but that cannot be made due to the percentage limit for current liability under Code Sec. 412(c)(7)(A)(i)(I) are amortized in equal annual installments over a 20-year period. Previously, such amounts were amortized over 10, rather than 20, years.

Effective date. A special provision applies to unamortized balances that exist as of the close of the plan year before the plan's first year beginning in 1999: amounts that could not be contributed due to the current liability full funding

limit and that have not been amortized as of the last day of the plan year beginning in 1998 are amortized in equal annual installments over the period of years that equal the excess of 20 years over the number of years since the amortization base was established. The changes made by this provision are otherwise generally effective for plan years beginning after December 31, 1998.

Act Sec. 1521(c)(1), amending Code Sec. 412(b)(2), and adding 412(b)(2)(E); Act Sec. 1521(c)(2), amending ERISA Sec. 302(b)(2), and adding 302(b)(2)(E); Act Sec. 1521(c)(3), amending Code Sec. 412(c)(7)(D) and ERISA Sec. 302(c)(7)(D); Act Sec. 1521(d). Law at ¶ 5149 and 7064. Committee Report at ¶ 13,340.

Minimum Funding Requirements

¶ 721

Background

The Code requires defined benefit plans to satisfy certain minimum funding requirements. Under prior law, there were no special minimum funding rules for plans sponsored by companies engaged primarily in the interurban or interstate passenger bus service. However, the Senate Finance Committee determined that it was appropriate to modify the minimum funding rules for such plans because, according to the Committee, the contributions required to be made to the plans under prior law caused them to be overfunded.

Modified funding requirements for bus company plans.—The Act modifies the minimum funding requirements of the Retirement Protection Act of 1994 for certain plans that are sponsored by a company that is engaged primarily in the interurban or interstate passenger bus service. Specifically, if the plan was not required to pay a variable rate PBGC premium for the plan year beginning in 1996 and has not, in any plan year beginning after 1995 and before 2009, merged with another plan (other than a plan sponsored by an employer that was a member of the controlled group of the employer in 1996), the modified minimum funding rules apply for any plan year beginning after 1996 and before 2010.

A plan to which the modified funding rules (transition rules) apply will be treated as having a funded current liability percentage of at least 90 percent for any plan year beginning after 1996 and before 2005 if for that year the plan's actual funded current liability percentage is at least 85 percent. Also, for any plan year beginning after 2004 and before 2010, the plan will be treated as having a funded current liability percentage of at least 90 percent if for that year the plan's actual funded current liability percentage is at least the minimum percentage determined under the following table:

Plan year beginning in:	*Minimum percentage*
2005	86
2006	87
2007	88
2008	89
2009 and thereafter	90

The Act also changes the Retirement Protection Act of 1994 so that it now amends the Code provisions describing the minimum amount of the full funding limit by replacing "90 percent" in those provisions with "85 percent" for plan years beginning after 1996 and before 2005 and with the applicable percentage set forth in the above table for plan years beginning after 2004 and before 2010.

If a plan's funded current liability percentage is less than 85 percent for any plan year beginning after 1996 and before 2005, the transition rules (described above) will continue to apply if contributions for that year are equal to the lesser of (1) the amount necessary to result in a funded current liability percentage of 85 percent or (2) the greater of (a) two percent of the plan's current liability as of the beginning of the plan year or (b) the amount necessary to result in a funded current liability percentage of 80 percent as of the end of the plan year. The transition rules described above will continue to apply for the plan year beginning in 2005 and the three succeeding plan years only if contributions to the plan for the year equal at least the expected increase in current liability due to benefits accruing during the plan year.

Effective date. This provision applies to plan years beginning after December 31, 1996.

Act Sec. 1508(a) adding Sec. 769(c) of the Retirement Protection Act of 1994; Act Sec. 1508(b). Law at ¶ 7055. Committee Report at ¶ 13,285.

DEFINED CONTRIBUTION PLANS

Tax on Nondeductible Contributions

¶ 725

Background

The Code imposes a 10-percent excise tax on nondeductible contributions to a qualified plan. However, this tax does not apply to contributions to one or more defined contribution plans that are not deductible solely because they exceed the combined plan deduction limit to the extent such contributions do not exceed six percent of compensation paid or accrued during the taxable year for which they were made.

Modification of 10-percent tax on nondeductible contributions.—The Act adds another exception to the 10-percent tax on nondeductible contributions. This exception provides that the 10-percent tax does not apply to contributions to one or more defined contribution plans which are not deductible solely because they exceed the combined plan deduction limit to the extent they do not exceed the sum of employer matching contributions and 401(k) elective deferrals made to the plan or plans.

Effective date. This provision applies to tax years beginning after December 31, 1997.

Act Sec. 1507(a), amending Code Sec. 4972(c)(6)(B); Act Sec. 1507(b). Law at ¶ 5525. Committee Report at ¶ 13,275.

401(k) PLANS

Diversification of Plan Assets

¶ 727

Background

Prior to the Act, employers were able to invest contribution amounts made to 401(k) plans on behalf of employees in corporate stock or other property. When two major corporations recently went bankrupt, the retirement plans of many of their

Background

employees who were 100 percent invested in company stock or other assets were wiped out.

Diversification of investments.—The Act amends ERISA to mandate diversification in Code Sec. 401(k) plan investments. The law now forbids companies from forcing employees to put more than 10 percent of their Code Sec. 401(k) plan funds in company stock or assets. The employees can maintain more than 10 percent if they do so voluntarily.

This provision of law does not apply to ESOPs or to individual account plans that only require 1 percent or less of an individual account's assets to be invested in employer securities.

PRACTICAL ANALYSIS. Bruce Ashton of Reish & Luftman, Los Angeles, points out that Act Sec. 1524, the so-called Boxer provision, amending § 407(b) of Title I of ERISA, will largely affect defined contribution plans of publicly-traded companies. Even then, the impact will be limited, since the provision only restricts the employer-directed investment of elective deferrals (and earnings thereon) in employer securities and employer real property to the extent they exceed one percent of the participant's compensation. The provision does nothing to restrict employee-directed investment in such assets. The effective date provision appears to grandfather investments made before December 31, 1998, by imposing the new statutory limitation only on elective deferrals for plan years beginning in 1999. This will require plans to maintain two separate accounts for participant deferrals, one for deferrals invested before December 31, 1998, and one for the investment of deferrals after that date.

Effective date. These changes apply to elective deferrals for plan years beginning after December 31, 1998. Although not included in the law, the Conference Committee Report also provided that these changes did not apply with respect to earnings on elective deferrals for years beginning before January 1, 1999.

Act Sec. 1524(a), amending ERISA Sec. 407(b) by redesignating paragraph (2) as (3) and adding new paragraph (2); Act Sec. 1524(b). Law at ¶ 7067. Committee Report at ¶ 13,365.

Self-Employed Matching Contributions

¶ 729

Background

Under prior law, matching contributions made for a self-employed individual to a 401(k) plan were treated as additional elective contributions by the self-employed individual who received the matching contributions. Therefore, the matching contributions were subject to the $9,500 limit on elective contributions.

In addition, it was not clear whether matching contributions to SIMPLE IRAs that were made on behalf of self-employed persons were treated as elective

Background

employer contributions and thus subject to the $6,000 limit on elective deferrals for SIMPLE IRAs.

Matching contributions of self-employed individuals not treated as elective employer contributions.—Under the Act, matching contributions made to 401(k) plans for self-employed persons are not treated as elective contributions and are, therefore, not subject to the limit ($9,500 for 1997) on elective contributions. This treatment of matching contributions does not apply to those qualified matching contributions that are treated as elective contributions for purposes of the actual deferral percentage (ADP) test under Code Sec. 401(k)(3)(D)(ii).

Previously, matching contributions for self-employed persons were treated as additional elective contributions. This differed from the treatment of matching contributions made by employers to 401(k) plans. Such contributions are not treated as elective contributions and thus are not subject to the $9,500 limit on elective contributions. In the Senate Finance Committee's view, it was inappropriate to treat self-employed persons differently from other employees with respect to the limit on elective contributions.

Planning Note. This provision should provide relief to sole proprietors with 401(k) plans that were violating the elective deferral limit (that is, the total of their deferrals and corresponding matches exceeded the limit). There is anecdotal evidence that quite a few sole proprietors were in breach of the limit and, therefore, many 401(k)s had this type of disqualifying defect.

SIMPLE IRAs. The Act also provides that matching contributions to SIMPLE IRAs that are made on behalf of self-employed persons are not treated as elective employer contributions and are not, therefore, subject to the $6,000 limit on elective deferrals for SIMPLE IRAs. Previously, such matching contributions were presumably treated as elective employer contributions and thus subject to the $6,000 limit.

PRACTICAL ANALYSIS. Fred Reish of Reish & Luftman, Los Angeles, notes that, in Treas. Reg. § 1.401(k)-1(a)(6)(iii), the IRS and Treasury Department interpreted Code Sec. 401(k) and the partnership tax rules as requiring that matching contributions for partners be treated as additional deferrals, subject to the Code Sec. 402(g) limit. As a practical matter, this interpretation eliminated matching contributions for partners in most 401(k) plans. While the IRS never formally extended this interpretation to sole proprietors, informally it has taken that position. Also, both IRS and Treasury officials have expressed their concerns that those Regulations required a similar conclusion for SIMPLE IRAs.

This statutory reversal of the Regulation eliminates one of the few remaining distinctions for qualified plans based on the form of the entity which sponsors a plan. This provision will primarily benefit small businesses, which are often organized as sole proprietorships, partnerships and limited liability companies (LLCs), and organizations which have historically been organized as partnerships and limited liability partnerships (LLPs), such as law firms and accounting firms. Perhaps the biggest beneficiaries, however, will be small businesses that have adopted SIMPLE

IRAs in 1997. Unlike 401(k) plans, there was no guidance for SIMPLE IRAs on whether matching contributions for the business owner were treated as deferrals. The new provision protects against the possibility of an inadvertent violation of the potential regulatory interpretation that self-employed SIMPLE sponsors were subject to the 401(k) restrictions. This accounts for the retroactive effective date of January 1, 1997, for SIMPLE IRAs under Code Sec. 408(p) (while the change for 401(k) plans is deferred until years beginning after December 31, 1997).

Effective date. The provision is generally effective for years beginning after December 31, 1997. In the case of SIMPLE IRAs, however, the provision is effective for years beginning after December 31, 1996.

Act Sec. 1501(a), adding Code Sec. 402(g)(9); Act Sec. 1501(b), adding Code Sec. 408(p)(8); Act Sec. 1501(c). Law at ¶ 5133 and 5139. Committee Report at ¶ 13,215.

Irrigation and Drainage Entities

¶ 731

Background

Under current law, taxable and tax-exempt employers may maintain qualified cash or deferred arrangements (401(k) plans), but state and local government organizations are generally barred from establishing 401(k) plans. This prohibition affected mutual irrigation and ditch companies and water districts because at least some of them are organized under state laws as municipal corporations.

Certain mutual irrigation and ditch companies could, apparently, sponsor 401(k)s as tax-exempt employers, but in order to be treated as tax-exempt employers, they were subject to the requirement that 85 percent or more of their income must consist of amounts collected from members for the sole purpose of meeting losses and expenses.

The effect of the above rules regarding governmental plans and tax-exempt status was to prevent some mutual irrigation and ditch companies and water districts from sponsoring 401(k) plans.

401(k) plans for irrigation and drainage entities.—Under the Act, mutual irrigation or ditch companies and districts organized under the laws of a state as municipal corporations for the purpose of irrigation, water conservation or drainage (or national associations of such organizations, according to the Conference Committee Report) may maintain qualified cash or deferred arrangements (401(k) plans).

Under prior law, state and local government organizations were generally barred from establishing 401(k) plans (after May 6, 1986). The Act lifts this prohibition for irrigation and drainage entities and permits such organizations to have 401(k) plans, even if the company or district is a state or local government organization.

The Act also opens the door for irrigation, ditch, and conservation entities to sponsor 401(k)s by permitting mutual irrigation or ditch companies described in Code Sec. 501(c)(12) to sponsor such plans without regard to the 85 percent

requirement under Code Sec. 501(c)(12). Without this change in the law, certain irrigation and ditch companies were apparently unable to sponsor 401(k) plans as tax-exempt organizations. Under current law, effective for plan years beginning in 1997, tax-exempt organizations may establish 401(k) plans for their employees. However, mutual irrigation or ditch companies have tax-exempt status under Code Sec. 501(c)(12)(A) *only* if 85 percent or more of their income consists of amounts collected from members for the sole purpose of meeting losses and expenses. This provision limited the number of irrigation and ditch companies that could sponsor 401(k)s.

In addition, the Act permits districts that are organized under state laws as municipal corporations, for the purpose of irrigation, water conservation, or drainage, to maintain 401(k) plans.

Effective date. The provision is effective with respect to years beginning after December 31, 1997.

Act Sec. 1525(a), amending Code Sec. 401(k)(7)(B); Act Sec. 1525(b). Law at ¶ 5131. Committee Report at ¶ 13,375.

SIMPLE IRA PLANS

Maximum Dollar Limitation

¶ 735

Background

Participants in a SIMPLE IRA may make elective contributions of up to $6,000 to their IRA. Employers may match the contributions or make a nonelective contribution equal to two percent of compensation for each eligible employee. However, confusion arose because the maximum amount that an individual may contribute to a traditional IRA is $2,000.

Maximum dollar limitation for SIMPLE IRAs.—Employees participating in a SIMPLE IRA may make elective contributions of up to $6,000 per year to their IRA, even though the maximum amount that may be contributed to a traditional IRA is $2,000. The $6,000 employee deferral may also be matched by the employer, resulting in a maximum deferral to the SIMPLE IRA of $12,000.

See, also, ¶ 729 for rules regarding matching contributions made on behalf of self-employed persons.

Planning Note. The $6,000 maximum annual salary reduction contribution also will be adjusted by the IRS to reflect changes in the cost of living. By contrast, the $2,000 maximum limit applicable to traditional IRAs is not adjusted for changes in the cost of living.

Nonelective contribution. The $2,000 maximum contribution limitation that governs traditional IRAs also does not apply to the alternative nonelective contribution an employer may make that is equal to two percent of each eligible employee's compensation for the entire calendar year.

> **Example.** ABC Company elects to make a nonelective contribution to its SIMPLE IRA for all of its employees. The maximum amount that may be added to each participant's SIMPLE IRA is $9,200 ($6,000 employee deferral plus an employer match of $3,200 [$160,000 (Code Sec. 401(a)(17) compensation limit) × 2 percent].

Effective date. The provision applies to tax years beginning after December 31, 1996.

Act Sec. 1601(d)(1)(D), adding Code Sec. 408(p)(8); Act Sec. 1601(j)(1). Law at ¶ 5139. Committee Report at ¶ 13,570.

Exclusive Plan Requirements

¶ 737

Background

A SIMPLE plan may not be established if the employer (or predecessor employer) maintains another qualified plan with respect to which contributions were made or benefits were accrued, for service in the period beginning with the year the SIMPLE plan became effective and ending with the year for which the determination was made. Prior law did not authorize an employer that maintained a qualified plan only for its collectively bargained employees to also maintain a SIMPLE IRA that was restricted to noncollectively bargained employees without violating the exclusivity requirement.

Application of exclusive plan requirements for SIMPLE IRAs to noncollectively bargained employees.—Employers may adopt a SIMPLE IRA for noncollectively bargained employees, even if the employer also maintains a qualified plan for collectively bargained employees.

A SIMPLE IRA will not be treated as a qualified salary reduction arrangement if the employer maintains a qualified plan (i.e., qualified retirement plan, governmental plan, tax-sheltered annuity, or simplified employee pension (SEP)) with respect to which contributions were made or benefits accrued during the same period that the SIMPLE IRA is maintained. Collectively bargained employees may be excluded from participation in a SIMPLE IRA, but may be covered under another qualified plan of the employer. Under the Act, the fact that an employer provides a qualified plan in which only collectively bargained employees may participate will not prevent it from establishing a SIMPLE IRA in which only noncollectively bargained employees may participate.

Caution. Employers may, at their option, elect to allow collectively bargained employees to participate in a SIMPLE plan. However, an employer that maintains a qualified plan for collectively bargained employees presumably could not allow those employees to also participate in the SIMPLE plan without violating the exclusivity rule, even if the plan is limited to collectively bargained employees.

Planning Note. Remember that all employees, whether or not members of a collective bargaining unit, are counted for purposes of determining whether the employer employed no more than 100 employees who received at least $5,000 in compensation from the employer in the preceding year.

Effective date. The provision applies to tax years beginning after December 31, 1996.

Act Sec. 1601(d)(1)(E), amending Code Sec. 408(p)(2)(D)(i); Act Sec. 1601(j). Law at ¶ 5139. Committee Report at ¶ 13,580.

¶ 739

Background

An employer who had maintained a SIMPLE IRA for at least one year, but who, because of an acquisition, disposition, or similar transaction, also maintained a qualified plan, was not allowed, under prior law, a grace period during which the SIMPLE IRA would remain a qualified salary reduction arrangement.

Application of exclusive plan requirement in case of mergers and acquisitions.—A SIMPLE IRA that is maintained by an employer for one or more years will not immediately cease to be a qualified salary reduction arrangement if the employer, because of an acquisition, disposition, or similar transaction with another employer, maintains a qualified plan in the same year that the SIMPLE plan is maintained. A grace period will allow the SIMPLE IRA to be treated as a qualified salary reduction arrangement for the year of the transaction and the following calendar year. Specifically, the Act, by adopting the transition period described in Code Sec. 410(b)(6)(C), effectively defines the grace period as beginning on the date of the transaction and ending on the last day of the first plan year beginning after the date of the transaction.

> **Example.** Company A operates a SIMPLE IRA plan for its employees. Company B maintains a defined benefit pension plan for its employees. Following A's purchase of B in August 1997, A may continue to operate the SIMPLE IRA as a qualified salary reduction arrangement for 1997 and 1998. However, during this time, B's employees may not participate in the SIMPLE IRA and participants in A's SIMPLE plan may not participate in the pension plan.

Caution. Employers also need to be aware that they may fail to be eligible to maintain or establish a SIMPLE plan if, following the merger or acquisition, they employ over 100 employees who received compensation for the preceding year of at least $5,000. Employers who have maintained a SIMPLE IRA for at least one year, however, may continue to maintain the plan for the *two* years following the last year the employer was eligible.

Effective date. The provision applies to tax years beginning after December 31, 1996.

Act Sec. 1601(d)(1)(F), adding Code Sec. 408(p)(2)(D)(iii); Act Sec. 1601(j)(1). Law at ¶ 5139. Committee Report at ¶ 13,590.

Reporting Requirements

¶ 740

Background

Trustees of a SIMPLE IRA were required under prior law to provide an account statement, reflecting the account balance as of the close of the calendar year and the account activity during the year, to each individual for whom a SIMPLE account was maintained within 30 days after each calendar year.

Reporting requirements for SIMPLE IRAs.—Trustees of a SIMPLE IRA and the issuer of an annuity for a SIMPLE IRA must furnish an account

statement, reflecting the account balance as of the close of the calendar year and the account activity during the year, to each individual for whom a SIMPLE account is maintained within 31 days after each calendar year. The Act conforms the time by which the required account statement for SIMPLE IRAs must be provided to the schedule generally applicable to conventional IRA reports.

Effective date. The provision applies to tax years beginning after December 31, 1996.

Act Sec. 1601(d)(1)(A), amending Code Sec. 408(i); Act Sec. 1601(j)(1). Law at ¶ 5139. Committee Report at ¶ 13,555.

Notification Requirements

¶ 741

Background

Trustees of a SIMPLE IRA are required, on an annual basis, to provide employers maintaining the arrangement with a summary description disclosing: the name and address of the employer and the trustee; the eligibility requirements for participation; the benefits provided under the plan; the time and method for making salary reduction elections; and the procedures for, and effect of, withdrawals (including rollover distributions) from the plan account. Under prior law, the requirement to provide the summary description did not apply to issuers of annuities for SIMPLE IRAs.

Notification requirements for SIMPLE IRAs.—Issuers of annuities for SIMPLE IRAs must meet reporting requirements that were previously applicable only to trustees of SIMPLE IRAs. Thus, issuers of annuities for SIMPLE IRAs must, on an annual basis, provide the employer maintaining the arrangement with a summary description disclosing: the name and address of the employer and the trustee or issuer; the eligibility requirements for participation; the benefits provided under the plan; the time and method for making salary reduction elections; and the procedures for, and effect of, withdrawals (including rollover distributions) from the plan account.

Planning Note. The IRS, in Notice 97-6 (I.R.B. 1997-2, Q&A H-1), authorized trustees of SIMPLE plans established through the use of Form 5305-SIMPLE to satisfy their reporting obligations by providing the employer with: a current copy of the Form 5305-SIMPLE; instructions and information required for completing Article VI of the form regarding the withdrawal of contributions by employees; and the name and address of the financial institution holding the SIMPLE plan contributions. Presumably, issuers of annuities for SIMPLE IRAs may follow the same procedure.

$50-per-day penalty. An issuer that fails to provide the required summary description, the account statement, or the annual reports is subject to a penalty of $50 per day until the failure is corrected. The penalty may be waived if the reporting failure was due to reasonable cause.

Planning Note. The IRS, in Notice 97-6 (I.R.B. 1997-2, Q&A H-1 and H-2), indicated that a trustee of a SIMPLE IRA will not be assessed a penalty for failing to provide the summary description to the employer, if the employer or trustee has provided the required information to eligible employees within the required time period. In addition, the penalty for failure to provide participants with an account statement will not be imposed if the statement is provided by January 31 following

the calendar year to which the statement relates. Again, this guidance should also apply to issuers of annuities for SIMPLE IRAs, as well as to trustees.

Caution. Issuers of an individual retirement annuity are already required to furnish an account statement to each individual maintaining a SIMPLE account and to file an annual report regarding the SIMPLE account with the Treasury Secretary.

Effective date. The provision is applicable to tax years beginning after December 31, 1996.

Act Sec. 1601(d)(1)(C), amending Code Secs. 408(l)(2)(B) and 6693(c)(2); Act Sec. 1601(j)(1). Law at ¶ 5139 and 5703. Committee Report at ¶ 13,565.

SIMPLE 401(k) PLANS

Employer Deduction Amount

¶ 743

Background

An employer's deduction for contributions to a SIMPLE 401(k) plan, unlike contributions to a SIMPLE IRA, under prior law, was limited to 15 percent of the total compensation of plan participants for the year.

Employer deduction for contributions to SIMPLE 401(k) arrangement.—An employer may deduct contributions to a SIMPLE 401(k) plan that are required to be made under Code Sec. 401(k)(11)(B). Under prior law, an employer's deduction for contributions to a SIMPLE 401(k) plan was limited to 15 percent of the total compensation of plan participants for the year. Under the Act, an employer's deduction is limited to the *greater* of 15 percent of the compensation paid or accrued during the tax year to beneficiaries under a stock bonus or profit-sharing plan, or the amount that the employer is required to contribute to the SIMPLE 401(k) plan for the year. Thus, an employer may deduct contributions to a SIMPLE 401(k) plan that are in excess of 15 percent of the compensation otherwise paid or accrued during the year.

Caution. In weighing the comparative advantages of a traditional 401(k) plan with a SIMPLE 401(k) plan, it should be noted that an employer's deduction for contributions to a traditional 401(k) plan is limited to 15 percent of the total compensation of plan participants for the year. Of course, an employer's contributions to a traditional 401(k) plan are optional, while an employer must make contributions to a SIMPLE 401(k) plan once it is established.

Planning Note. Employers with a SIMPLE 401(k) plan may maintain other plans as long as employees covered by the SIMPLE 401(k) arrangement are not covered by the other plans. Under Code Sec. 404(a)(3), as amended, an employer that maintains a profit-sharing or stock bonus plan and a SIMPLE 401(k) arrangement may apparently, however, not deduct contributions to *both* arrangements, but is limited to the *greater* of the contribution deductions. Thus, if an employer's SIMPLE 401(k) contributions exceed the 15 percent of compensation contributed to the profit-sharing plan, the total amount of the SIMPLE 401(k) contributions may be deducted, but the contribution to the profit-sharing plan could not be deducted. However, the amendment does not allow an employer to deduct contributions to the profit-sharing plan that exceed the 15 percent limit.

Carrying over deduction. In addition, contributions that exceed the applicable deduction limit may be carried over and deducted in succeeding years. The deduction may not exceed the greater of 15 percent of the compensation otherwise paid or accrued during the tax year to beneficiaries under the stock or bonus plan or the amount the employer is required to contribute to the SIMPLE 401(k) plan.

Planning Note. The deduction limits do not apply to a SIMPLE IRA. Accordingly, an employer may deduct all of the elective deferrals, matching and nonelective contributions to a SIMPLE IRA.

Effective date. The provisions are effective for plan years beginning after December 31, 1996.

Act Sec. 1601(d)(2)(C), amending Code Sec. 404(a)(3)(A)(i) and (ii); Act Sec. 1601(j)(1). Law at ¶ 5137. Committee Report at ¶ 13,620.

Cost-of-Living Adjustments

¶ 745

Background

The maximum salary reduction contribution that may be made on behalf of any employee under a SIMPLE 401(k) plan is $6,000 per year. Prior law clearly authorized a cost-of-living adjustment to the $6,000 maximum elective deferral that may be made to a SIMPLE IRA. However, the law did not specifically provide for an adjustment to the maximum deferral allowed under a 401(k) SIMPLE plan.

Cost-of-living adjustments (COLAs) for SIMPLE 401(k) arrangements.—The $6,000 annual limit on elective deferrals under a SIMPLE 401(k) plan will be adjusted to reflect changes in the cost of living. The Small Business Job Protection Act (P.L. 104-188), while clearly authorizing an inflation adjustment for the maximum elective deferral to a SIMPLE IRA, did not specifically provide for an adjustment to the maximum deferral allowed under a SIMPLE 401(k) plan.

Planning Note. The adjustment to elective deferrals under a SIMPLE 401(k) plan will be made at the same time and in the same manner as the adjustment for deferrals to a SIMPLE IRA. Cost-of-living adjustments are made in increments of $500. The base period is the calendar quarter ending September 30, 1996. Any increase that is not a multiple of $500 is rounded to the next lowest $500.

Caution. Despite the provision for cost-of-living adjustments, employers willing to bear the additional administrative burdens may allow employees to shelter more money in a traditional 401(k) plan or SEP. Employees may defer up to $9,500 in 1997 under a traditional 401(k) or SEP, compared with $6,000 for a SIMPLE plan. In addition, a traditional 401(k) plan allows an employer to make additional contributions on behalf of an employee up to a limit that, when combined with the employee's elective deferrals, does not exceed $30,000 or 25 percent of the employee's compensation.

Effective date. The provision applies to plan years beginning after December 31, 1996.

Act Sec. 1601(d)(2)(B), adding Code Sec. 401(k)(11)(E); Act Sec. 1601(j)(1). Law at ¶ 5131. Committee Report at ¶ 13,615.

Top-Heavy Exemption

¶ 747

Background

A plan that satisfied the SIMPLE 401(k) requirements for a year is exempt from the rules applicable to top-heavy plans under Code Sec. 416. Prior to the Taxpayer Relief Act of 1997, confusion had arisen as to whether this top-heavy exemption was limited to plans that allowed only contributions necessary to satisfy the SIMPLE 401(k) rules or also covered other plans of the employer.

Top-heavy exemption for SIMPLE 401(k) arrangements.—A SIMPLE 401(k) plan that authorizes only contributions required to satisfy the SIMPLE 401(k) requirements of Code Sec. 401(k)(11) is exempt from treatment as a "top-heavy" plan under Code Sec. 416. The amendment clarifies the Congressional intent to apply the top-heavy exemption to SIMPLE 401(k) plans only, and not to other 401(k) arrangements maintained by the employer.

Caution. The top-heavy exemption is one of the primary attractions of a SIMPLE 401(k) plan. Plans are considered top-heavy if the sum of the account balances of key employees exceeds 60 percent of the sum of the account balances of all employees under the plan. If a plan is top-heavy, the employer must make a minimum contribution of three percent of compensation for each participant who is not a key employee. Elective deferrals may not be used to satisfy the minimum contribution that must be made for non-key employees in a top-heavy 401(k) plan, nor may matching contributions be directed towards the top-heavy minimum contribution requirements.

Effective date. The amendment applies to plan years beginning after December 31, 1996.

Act Sec. 1601(d)(2)(A), amending Code Sec. 401(k)(11)(D)(ii); Act Sec. 1601(j)(1). Law at ¶ 5131. Committee Report at ¶ 13,595.

Notification and Election Periods

¶ 749

Background

The Small Business Job Protection Act (SBJPA) (P.L. 104-188) imposed specific obligations on employers maintaining SIMPLE IRAs to notify eligible employees of their right to make or modify salary reduction contributions under the plan. The SBJPA did not expressly address the notification requirements or election periods applicable to SIMPLE 401(k) arrangements. However, the IRS, in Rev. Proc. 97-9 (I.R.B. 1997-2), clarified that requirements could also be applied to SIMPLE 401(k) plans.

Notification and election requirements for SIMPLE 401(k) plans.—An employer maintaining a SIMPLE 401(k) plan must allow employees to make elections to participate in the arrangement and must notify eligible employees, within a stipulated period of time, of their right to participate in the arrangement and to make or modify salary reduction contributions. The Act effectively extends the notice and election requirements applicable to SIMPLE IRAs to SIMPLE 401(k) plans.

Election requirements. In Rev. Proc. 97-9 (I.R.B. 1997-2), the IRS explained that each eligible employee may make or modify a salary reduction (elective deferral) during the 60-day period immediately preceding each January 1. For the year an employee becomes eligible to make elective deferrals, the 60-day election period requirement is deemed to be satisfied if the employee may make or modify a salary reduction election during a 60-day period that includes either the date the employee becomes eligible or the day before. The Act codifies these rules and applies the election requirements governing SIMPLE IRAs under Code Sec. 408(p)(5) to SIMPLE 401(k) arrangements.

Example (1). ABC Company maintains a SIMPLE 401(k) plan. For the 1998 calendar year, employees of ABC must be allowed to make a salary reduction election during the period between November 2 to December 31, 1997.

Example (2). XYZ Company establishes a SIMPLE 401(k) plan, effective as of July 1, 1997. Employees become eligible to make elective deferrals on that date. The 60-day period must begin no later than July 1 and may not end before June 30, 1997.

Planning Note. In Notice 97-6 (I.R.B. 1997-2), the IRS explained that for the year in which an employee becomes eligible to make elective deferrals to a SIMPLE IRA, these contributions must be allowed to begin as soon as the employee becomes eligible, regardless of whether the 60-day period has ended. Presumably, this rule will now also apply to employees participating in SIMPLE 401(k) plans. Similarly, as a SIMPLE IRA is not precluded from adopting additional or longer election periods, such as 90 days, a SIMPLE 401(k) plan should also not be prohibited from instituting a longer election period.

Termination of participation. An employee participating in a SIMPLE 401(k) plan may terminate a salary reduction election at any time during the year. The Act, by applying the rules governing SIMPLE IRAs under Code Sec. 408(p)(5)(B) to SIMPLE 401(k) plans, provides that if an employee terminates a salary reduction election, the plan may refuse to allow the employee to resume participation until the beginning of the next calendar year.

Notification of election period. An employer maintaining a SIMPLE 401(k) plan must notify each employee eligible to participate in the arrangement of the employee's right during the governing 60-day period discussed above to make or modify a salary reduction contribution to the plan. The notice must be provided within a reasonable period of time before the 60th day before the beginning of the year, or for the first year of the employee's eligibility, the 60th day before the first day the employee is eligible.

Caution. It is the responsibility of the employer and not the trustee to inform employees of their rights under the SIMPLE 401(k) plan.

Planning Note. The requirement that an employer maintaining a SIMPLE IRA include a copy of the summary description prepared by the trustee for the employer in the notice presumably now also applies to employers establishing SIMPLE 401(k) arrangements. In addition, according to IRS Notice 97-9, the notice must also indicate whether the employer will provide a three-percent matching contribution or a two-percent nonelective contribution.

Caution. Employers maintaining SIMPLE IRAs who fail to satisfy the notice requirement are subject to a penalty of $50 per day until the notice is provided.

Presumably, employers who fail to provide the required notice to employees participating in SIMPLE 401(k) arrangements would incur the same penalty.

Effective date. The provisions apply to calendar years beginning after August 5, 1997.

Act Sec. 1601(d)(2)(D), adding Code Sec. 401(k)(11)(B)(iii); Act Sec. 1601(j)(2). Law at ¶ 5131. Committee Report at ¶ 13,625.

ESOPs

S Corporations—Cash Distributions and Prohibited Transactions

¶ 752

Background

ESOP participants generally have the right to demand that their ESOP distributions be made in employer securities, unless the employer's charter or bylaws restrict ownership of substantially all outstanding employer securities to employees or a trust (i.e., the ESOP). Prior to the Taxpayer Relief Act of 1997, this rule also applied to an ESOP maintained or established by an S corporation even though the ESOP provided that the participants had the right to receive distributions in cash.

Additionally, under prior law, the statutory exemptions to the prohibited transaction rules for ESOPs in general did not apply to certain transactions involving shareholder employees of S corporations that maintain ESOPs.

Cash distribution option and prohibited transaction exemption for ESOPs of S corporations.—The Act provides that ESOPs established or maintained by S corporations need not give participants the right to demand their distributions in the form of employer securities, if they have the right to receive such distributions in cash. This was added as an exception to the prior law requirement that ESOP participants have the right to demand stock distributions. The Act also creates a statutory exemption from the prohibited transaction rules for ESOPs established or maintained by S corporations by exempting the sale of employer securities to the ESOP by a shareholder employee, family member of the shareholder employee, or corporation in which the shareholder employee owns at least 50 percent of the stock.

Caution. The Conference Committee Report, which states that the House bill provides that ESOPs of S corporations may distribute cash to plan participants as long as the employee has a right to require the employer to purchase employer securities, conflicts with the House bill.

Effective date. These provisions apply to tax years beginning after December 31, 1997.

Act Sec. 1506(a)(1), adding Code Sec. 409(h)(2)(B); Act Sec. 1506(a)(2), amending Code Sec. 409(h)(2); Act Sec. 1506(b)(1)(A), adding Code Sec. 4975(f)(6); Act Sec. 1506(b)(1)(B), amending Code Sec. 4975(d); Act Sec. 1506(b)(2), amending ERISA Sec. 408(d); Act Sec. 1506(c). Law at ¶ 5143, 5529 and 7052. Committee Report at ¶ 13,265.

S Corporations and Unrelated Business Income Tax

¶ 755

Background

Under prior law, in the case of an ESOP that was a shareholder in an S corporation, items of income or loss of the S corporation were treated as unrelated business taxable income for the ESOP. The items of income or loss of the S corporation "flowed through" to such ESOPs, resulting in taxation of the UBTI amounts both at the ESOP level and again when benefits were distributed to ESOP participants.

Repeal of application of UBIT to ESOPs of S corporations.—Employee stock ownership plans (ESOPs) may be shareholders of S corporations in post-1997 tax years. Under the Act, in the case of an ESOP that is an S corporation shareholder, items of income or loss of the S corporation will not be treated as unrelated business taxable income (UBTI). Previously, such items were treated as UBTI.

According to the Senate Finance Committee Report, it is believed that the prior law inappropriately resulted in taxation of these amounts both at the ESOP level and then again when benefits were distributed to ESOP participants.

Effective date. This provision is effective for tax years beginning after December 31, 1997.

Act Sec. 1523(a), adding Code Sec. 512(e)(3); Act Sec. 1523(b). Law at ¶ 5173. Committee Report at ¶ 13,355.

GOVERNMENT PLANS

Nondiscrimination Rules

¶ 758

Background

Under prior law, governmental plans were not required to comply with certain nondiscrimination rules until plan years beginning on or after the later of (1) January 1, 1999 or (2) 90 days after the opening of the first legislative session beginning on or after January 1, 1999. This deadline was the result of an extension provided by the IRS in Announcement 95-48, I.R.B. 1995-23, 13, and other IRS releases. Government plans were "deemed" to satisfy the nondiscrimination requirements for those plan years that began before the extended effective date.

The nondiscrimination rules include those that prohibited discrimination in favor of highly compensated employees with regard to contributions and benefits, participation, coverage, and the compensation taken into account under the plan.

Extension of moratorium on application of certain nondiscrimination rules to employee retirement plans sponsored by state and local governments.—Under the Act, governmental retirement plans are exempt from minimum coverage requirements and nondiscrimination rules that include the minimum participation standards, the 50-40 minimum number of participants rule, the rule barring discrimination in contributions and benefits in favor of highly compensated employees, the participation and actual deferral percentage nondis-

crimination rules applicable to 401(k) plans, and nondiscrimination requirements applicable to contributions made to 403(b) annuities. In addition, the Committee Report states that governmental plans are also exempted from the nondiscrimination rules involving the actual contribution percentage test.

With respect to the participation and nondiscrimination standards applicable to 401(k) plans, the Act provides that a cash or deferred arrangement under a governmental plan will be treated as a qualified cash or deferred arrangement, even if the actual deferral percentage test is not satisfied.

Previous extension of deadline for compliance. The IRS had previously granted governmental plans an extension for complying with certain nondiscrimination rules. The extended deadline for compliance was the later of (1) January 1, 1999 or (2) 90 days after the opening of the first legislative session beginning on or after January 1, 1999. The Act permanently exempts governmental plans from having to comply with the rules.

PRACTICAL ANALYSIS. Fred Reish of Reish & Luftman, Los Angeles, notes that the Tax Reform Act of 1986 extended a number of the private-sector qualification rules to governmental plans. State and local governments lobbied for repeal of many of these provisions on the basis that they were not appropriate for governmental plans. The effective date of the coverage and nondiscrimination rules were, as a consequence, repeatedly extended. The effect of Act Sec. 1505 is to eliminate the application of the coverage rules of Code Secs. 410 and 401(a)(26) and the nondiscrimination rules of Code Sec. 401(a)(4) for government plans, thus dramatically reducing the burden of compliance for these plans. State and local governments view this as welcome and deserved recognition of the difficulty in applying complex rules to their retirement plans.

Effective date. The amendments made by this provision are effective with respect to tax years beginning on or after August 5, 1997. In addition, governmental plans will be retroactively treated as satisfying the coverage and nondiscrimination tests for all tax years beginning before August 5, 1997.

Act Sec. 1505(a)(1), adding Code Sec. 401(a)(5)(G); Act Sec. 1505(a)(2), amending Code Sec. 401(a)(26)(H); Act Sec. 1505(a)(3), amending 410(c)(2); Act Sec. 1505(b), adding 401(k)(3)(G); Act Sec. 1505(c), adding Code Sec. 403(b)(12)(C); Act Sec. 1505(d). Law at ¶ 5131, 5135, and 5145. Committee Report at ¶ 13,255.

Permissive Service Credit

¶ 760

Background

Under prior law, retirement plans sponsored by state or local governments were subject to special contribution and benefit limits. Employee contributions to a governmental plan were treated as made by the employer if the employer "picked up" the contribution.

Portability of permissive service credits under governmental pension plans.—Many state or local governmental plans ease portability of pension benefits by permitting employees to purchase credit for service with another governmental employer and for certain other service, as provided in the plan. In an effort to encourage portability of benefits between governmental plans, the Act provides that, when applying the defined benefit plan limits, the annual benefit under a state or local governmental plan includes accrued benefits derived from contributions to purchase permissive service credits. These contributions are also taken into account in determining annual additions to defined contribution plans.

Permissive service credits defined. Permissive service credits are defined as credits for a period of service recognized by the governmental plan (and which the employee has not received under the plan) only if the employee voluntarily contributes an amount (as actuarially determined by the plan) which does not exceed the amount necessary to fund the benefit attributable to the period of service. This contribution must be in addition to regular contributions, if any, to the plan.

A special rule applies for the repayment of cashouts under governmental plans. Under this rule, if any repayment of contributions and earnings is made to a governmental plan regarding an amount that was previously refunded due to a forfeiture of service credit under the plan (or under another plan maintained by a state or local government employer within the same state), any such repayment is not taken into account for purposes of Code Sec. 415. In addition, service credit obtained as a result of the repayment is not considered permissive service credit, according to the Conference Committee Report.

Limits on contributions to purchase permissive service credits. A participant's contributions in a state or local governmental plan to purchase permissive service credits are subject to one of two limits.

Under the first alternative, the accrued benefit derived from all contributions to purchase permissive service credit must be taken into account in determining whether the Code Sec. 415(b) defined benefit plan limit is satisfied. Under this alternative, a plan does not fail to satisfy the reduced defined benefit plan limit that applies in cases of early retirement due to the accrued benefit (under Code Sec. 415(b)(2)(C)) derived from the purchase of permissive service credits. These limits may be applied on a participant-by-participant basis (i.e., contributions used to purchase permissive service credits by all participants in the same plan do not have to satisfy the same limit).

Under the second alternative, all such contributions must be taken into account in determining whether the Code Sec. 415(c) limit on annual additions to a defined contribution plan is met (taking into account any of the participant's other annual additions). Under this alternative, a plan will not fail to satisfy the 25 percent of compensation prong of the Code Sec. 415(c) defined contribution plan limit solely by reason of the permissive service credit rules.

Caution. According to the Conference Committee Report, this provision is not intended to affect the application of "pick-up" contributions to purchase permissive service credit or the treatment of "pick up" contributions under the Code Sec. 415 limits. However, language specifically expressing this intent was dropped from the final version of the Act.

Nonqualified service. Code Sec. 415 is violated if more than five years of permissive service credit is purchased for "nonqualified service." There is also a

violation of Code Sec. 415 if nonqualified service is taken into account for an employee who has less than five years of participation under the plan.

"Nonqualified service" is defined as service other than (1) service as a federal, state, or local government employee; (2) service as an employee of an association representing federal, state, or local government employees; (3) service as an employee of an elementary or secondary school; or (4) military service. However, service as a government employee, an employee of an association representing government employees, or as a school employee under definitions (1), (2), and (3), above, is not qualified if it enables a participant to receive a retirement benefit for the same service under more than one plan.

Planning Note. For this purpose, "service" as a government employee or as a school employee specifically includes parental, medical, sabbatical, and similar leave.

Effective date. In general, this provision is effective for contributions to purchase permissive service credits made in years beginning after December 31, 1997.

However, a transition rule applies for plans that provided for the purchase of permissive service credit on August 5, 1997. Under the transition rule, the defined contribution plan limits on contributions and additions do not reduce the amount of permissive service credits an eligible participant is allowed to purchase under the plan's terms as in effect on August 5, 1997. An "eligible participant," for purposes of the transition rule, is a person who first became a plan participant before the first plan year beginning after the last day of the calendar year in which the next regular session (after August 5, 1997) of the government body with authority to amend the plan ends.

Act Sec. 1526, adding Code Sec. 415(k)(3) and (n). Law at ¶ 5153. Committee Report at ¶ 13,385.

Police and Fire Employee Plans

¶ 764

Background

The limit on annual benefits under a defined benefit plan is the lesser of 100 percent of compensation or $90,000 ($125,000 after adjustment for inflation in 1997). If retirement benefits under a defined benefit plan begin before the social security retirement age, the adjusted dollar limit must be reduced actuarially so that it is the actuarial equivalent of an annual benefit equal to the adjusted dollar limitation, beginning at the social security retirement age.

Prior law provided special rules for police officers and firemen. The reduction in the adjusted dollar limit would not go below $50,000 ($70,000 after adjustment for inflation in 1997) and if retirement benefits began before age 62, the adjusted dollar limit would have to be reduced actuarially so that it was the actuarial equivalent of an annual benefit equal to the adjusted dollar limitation, beginning at age 62.

Defined benefit limits for police and firemen.—The reduction in the annual dollar limitation on retirement benefits for police officers and firemen who retire at age 62 has been removed by the Act. The $125,000 defined benefit plan dollar limit continues to apply to these individuals. Thus, police officers or firemen

who retire at age 62 in 1997 or later will be entitled to a benefit of up to $125,000 (as adjusted for inflation in 1997) without exceeding the limitations under Code Sec. 415 each year. According to the Conference Committee Report, the annual dollar limit is increased for such employees if benefits begin after age 65, as under present law.

Effective date. Effective for years beginning after December 31, 1996.

Act Sec. 1527(a), amending Code Sec. 415(b)(2)(G); Act Sec. 1527(b). Law at ¶ 5153. Committee Report at ¶ 13,395.

CHURCH PLANS AND MINISTERS

Contributions for Self-Employed Ministers

¶ 766

Background

Contributions made to retirement plans by ministers who were self-employed were deductible to the extent such contributions did not exceed certain limitations applicable to retirement plans. These limitations included the limit on elective deferrals, the exclusion allowance, and the limit on annual additions to a retirement plan.

Treatment of ministers as church employees.—Contributions to a church plan made on behalf of a minister who is self-employed are excludable from the minister's income to the extent that the contribution would be excludable if the minister was an employee of the church and the contribution was made to the plan.

According to the Conference Committee Report, this change does not alter the existing requirements under which amounts contributed on behalf of a minister under Code Sec. 403(b) by the minister's actual employer or by any church or convention or association of churches that is treated as the minister's employer under Code Sec. 414(e) are excluded from the minister's income. Further, a minister's contributions (made under Code Sec. 403(b)) as an employee or self-employed person are deductible, as provided by Code Sec. 404 and other rules under Code Sec. 414(e).

Effective date. This special rule applies to years beginning after December 31, 1997.

Act Sec. 1522(a)(2) adding Code Sec. 414(e)(5)(E); Act Sec. 1522(b). Law at ¶ 5151. Committee Report at ¶ 13,347.

Discrimination Testing

¶ 768

Background

Ministers who are employed by an organization other than a church are treated as if employed by the church and can participate in the retirement plan sponsored by the church. If the organization also sponsored a retirement plan, that plan did not have to include the ministers as employees for purposes of satisfying the nondiscrimination rules applicable to qualified plans so long as the organization *was not eligible to participate* in the church plan.

Organization not participating in church plan.—If a minister is employed by an organization other than a church and the organization is not otherwise participating in a church plan, then the minister does not have to be included as an employee under the retirement plan of the organization for purposes of the nondiscrimination rule.

Formerly, the minister would have been counted for nondiscrimination purposes if the organization was eligible to participate in the church plan.

Effective date. This new rule applies to years beginning after December 31, 1997.

Act Sec. 1522(a)(1), amending Code Sec. 414(e)(5)(C); Act Sec. 1522(b). Law at ¶ 5151. Committee Report at ¶ 13,345.

EMPLOYEE ANNUITIES

Code Sec. 403(b) Exclusion Allowance

¶ 776

Background

In general, the exclusion allowance under Code Sec. 403(b) limits the annual contributions that can be made on behalf of an employee to a Code Sec. 403(b) plan. Such limit may be determined under Code Sec. 415 rather than Code Sec. 403(b), at the election of the employee.

Under prior law, the definition of includible compensation for purposes of the exclusion allowance excluded elective deferrals and contributions made on behalf of an employee to a cafeteria plan or Code Sec. 457 plan which were not includible in the employee's gross income.

Also, the regulations under Code Sec. 403(b) that relate to the exclusion allowance refer to the combined plan benefit limit under Code Sec. 415 which was repealed by the Small Business Job Protection Act of 1996 (P.L. 104-188).

Modification of Section 403(b) exclusion allowance to conform to Section 415 modifications.—The Act amends the definition of includible compensation for purposes of the exclusion allowance under Code Sec. 403(b) to include elective deferrals and any amounts contributed or deferred by the employer at the election of the employee under a cafeteria plan (Code Sec. 125 plan) or a plan maintained by a tax-exempt organization or State or local government (Code Sec. 457 plan) which are not includible in the employee's gross income. The Act thus conforms the definition of includible compensation to the definition of compensation in Code Sec. 415(c).

Additionally, the Act directs the Secretary of the Treasury to modify the regulations regarding the exclusion allowance under Code Sec. 403(b)(2) to reflect the repeal of the combined plan benefit limitation under Code Sec. 415(e) by the Small Business Job Protection Act of 1996 (P.L. 104-188).

Effective date. The amendment of the definition of includible compensation is effective for years beginning after December 31, 1997. The modification to the

regulations regarding the exclusion allowance will take effect for years beginning after December 31, 1999.

Act Sec. 1504(a), amending Code Sec. 403(b)(3); Act Sec. 1504(b). Law at ¶ 5135. Committee Report at ¶ 13,245.

Indian Tribal Government Plans

¶ 779

Background

Under prior law, it was unclear whether 403(b) annuity contracts purchased by Indian tribal governments had to be terminated in order for rollovers to 401(k) plans to be allowed.

Rollover from 403(b) plan to 401(k) plan.—Employees participating in 403(b) annuities offered by Indian tribal governments may roll over amounts received from the 403(b) plan to a 401(k) plan sponsored by the Indian tribal government. This rollover is permitted whether or not the annuity contract is terminated.

Effective date. This provision is effective as if included in the Small Business Job Protection Act of 1996. As a result, it it effective August 20, 1996.

Act Sec. 1601(d)(4), affecting Code Sec. 403(b)(11) and Sec. 1450(b) of the Small Business Job Protection Act. Law at ¶ 1535 and 7076. Committee Report at ¶ 13,630.

Basis Recovery Rules

¶ 781

Background

A simplified method is provided for determining the portion of an annuity distribution from a qualified retirement plan, qualified annuity, or tax-sheltered annuity that represents the nontaxable return of basis.

Under the simplified method, the portion of each annuity payment that represents nontaxable return of basis is generally equal to the employee's total investment in the contract as of the annuity starting date, divided by the number of anticipated payments, which are determined by reference to the age of the participant as listed in the table below:

Age of Distributee	*Number of Payments*
55 and under	360
56-60	310
61-65	260
66-70	210
71 and over	160

This table for determining anticipated payments did not differ depending on whether the annuity was payable in the form of a single life annuity or a joint and survivor annuity. Applying the table for single life annuities to joint and survivor annuities understated the expected payments under a joint and survivor annuity.

Basis recovery rules for annuities.—The Act requires one table to be applied to benefits based on the life of one annuitant for amounts received as an annuity under a tax-qualified pension plan and a separate table to be applied to benefits based on the life of more than one annuitant for amounts received as an annuity.

The table for one annuitant (same as under current law) is:

Age of Annuitant	*Number of Payments*
not more than 55	360
more than 55 but not more than 60	310
more than 60 but not more than 65	260
more than 65 but not more than 70	210
more than 70	160

The new table based on the lives of more than one annuitant:

Combined Age of Annuitants	*Number of Payments*
not more than 110	410
more than 110 but not more than 120	360
more than 120 but not more than 130	310
more than 130 but not more than 140	260
more than 140	210

According to the Conference Committee Report, the new table applies to benefits based on the life of multiple annuitants even if the amount of the annuity varies by annuitant. Thus, it applies to a 50-percent joint and survivor annuity.

Effective date. Effective for annuity starting dates beginning after December 31, 1997.

Act Sec. 1075(a), adding Code Sec. 72(d)(1)(B)(iv); Act Sec. 1075(b), amending Code Sec. 72(d)(1)(B)(iii); Act Sec. 1075(c). Law at ¶ 5041. Committee Report at ¶ 11,485.

SARSEPs

New Employees

¶ 785

Background

Salary reduction SEPs (SARSEPs) were repealed for years beginning after December 31, 1996. Thus, an employer could not establish a SARSEP after 1996. However, SARSEPs established before 1997 could continue to receive contributions under the pre-1997 rules.

Under pre-1997 rules, the election to have amounts contributed to a SARSEP was available only if:

1. at least 50% of employees who were eligible to participate elected to have amounts contributed to the plan, and

2. the employer did not have more than 25 eligible employees at any time during the preceding tax year.

Prior to the 1997 Act, it was not certain whether employees hired after 1996 could participate in an existing SARSEP.

New employees may participate in SARSEPs.—The Act clarifies that new employees hired after December 31, 1996, may participate in the salary reduction SEP (SARSEP) of their employer established prior to January 1, 1997.

Effective date.—This clarification is effective for tax years beginning after December 31, 1996.

Act Sec. 1601(d)(1)(B), amending Code Sec. 408(k)(6)(H); Act Sec. 1601(j)(1). Law at ¶ 5139. Committee Report at ¶ 13,560.

GATT

Interest and Mortality Rate Provisions

¶ 788

Background

The Small Business Job Protection Act of 1996 (P.L. 104-188) amended the Uruguay Round Agreements Act (implementing legislation for the General Agreements on Tariffs and Trade ("GATT")) to permit plans to apply pre-GATT law under Code Sec. 415(b)(2)(E) for a transition period. However, the Small Business Act provision included a parenthetical phrase that thwarted such intent.

Correction of GATT interest and mortality rate provisions.—Plans may apply, for a transition period, the interest and mortality rate assumptions that existed under Code Sec. 415 prior to the modification of such assumptions by the Uruguay Round Agreements Act (implementing legislation for the General Agreements on Tariffs and Trade ("GATT")). In the case of a plan that was adopted and in effect before December 8, 1994, such GATT changes are not effective with respect to benefits accrued before the earlier of (1) the later of the date a plan amendment applying the amendments is adopted or made effective or (2) the first day of the first limitation year beginning after December 31, 1999. The actuarial assumptions for such benefits are to be determined on the basis of Code Sec. 415(b)(2)(E) as in effect on December 7, 1994 and the provisions of the plan as in effect on December 7, 1994, but only if the provisions of the plan satisfy the requirements of Code Sec. 415(b)(2)(E) then in effect.

A provision in the Small Business Job Protection Act of 1996 was enacted to permit the application of pre-GATT law. However, since that intent was not effectively carried out by that provision, the Act conforms the Uruguay Round Agreements Act to such intent by amending its statutory (the GATT's) language.

Effective date. These provisions are effective for plan years and limitation years beginning after December 31, 1994, except that an employer may elect to treat them as being effective on or after December 8, 1994.

Act Sec. 1604(b)(3), amending Section 767(d)(3)(A) of the Uruguay Round Agreements Act implementing agreements related to GATT; Act Sec. 1604(b)(4). Law at ¶ 7082. Committee Report at ¶ 13,935.

PLAN AMENDMENTS UNDER ACT

Date for Adoption

¶ 790

Background

Employers have generally been required to amend their plans to reflect changes implemented by prior legislation by the deadline prescribed for filing their income tax returns for the tax year in which the change occurred.

Date for adoption of plan amendments.—Employers are not required to amend a plan or annuity contract to reflect changes implemented by the Act before the first day of the first plan year beginning on or after January 1, 1999. Governmental plans need not be amended to reflect the provisions of the Act until the first day of the first plan year beginning on or after January 1, 2001.

According to the Conference Committee Report, employers may adopt an amendment before the time period prescribed by the Act. However, in order to avoid losing its qualified status for failing to be operated in accordance with its terms or violating the anti-cutback rules applicable to qualified plans, the plan or annuity contract must be operated as if the amendment were in effect during the period between the effective date of the legislative change (or the effective date specified by the plan for amendments not required by the Act) and the amendment period prescribed by the Act (see above), or the date the amendment is adopted. Additionally, the amendment must apply retroactively to such period.

Act Sec. 1541. Law at ¶ 7072. Committee Report at ¶ 13,485.

Chapter 8

Health and Life Insurance

MEDICAL SAVINGS ACCOUNTS

Alternative Minimum Tax

¶ 801

Background ___

Under prior law, unlike the additional tax imposed on early withdrawals from IRAs or from qualified retirement plans, the 15 percent additional tax on MSA distributions was treated as a tax liability for purposes of the alternative minimum tax rules under Code Sec. 26. MSA distributions that are not made for medical purposes are subject to an additional tax of 15 percent unless the distribution is made after age 65 or on account of death or disability.

Additional tax on MSA distributions that are not used for medical purposes.—The 15-percent additional tax on medical savings account distributions that are used for nonmedical purposes (i.e., not qualified medical expenses within the meaning of Code Sec. 220(d)) is not treated as a tax liability for purposes of the alternative minimum tax.

Effective date. This provision is effective as if included in the Health Insurance Portability and Accountability Act of 1996. As a result, it is effective for tax years beginning after December 31, 1996.

Act Sec. 1602(a)(1), adding Code Sec. 26(b)(2)(P) and amending Code Sec. 26(b)(2)(N) and (O); Act Sec. 1602(i). Law at ¶ 5011. Committee Report at ¶ 13,755.

Permitted Coverage

¶ 804

Background

A person is ineligible for a medical savings account if he or she is covered by another plan that is not a high deductible health plan, except for plans that provide certain kinds of permitted coverage. Under prior law, participation in a Medicare supplemental plan was disregarded for purposes of the MSA eligibility rules even though a person covered by Medicare was not eligible for an MSA before passage of the Balanced Budget Act of 1997.

Coverage under Medicare supplemental policies.—An individual with Medicare supplemental insurance is ineligible to have a medical savings account. Medicare supplement policies are deleted from the list of "permitted insurance" for purposes of the MSA eligibility rules.

Planning Note. Under the Balanced Budget Act of 1997, eligible seniors are entitled to establish Medicare medical savings accounts called "MedicarePlus Choice MSAs." See ¶ 817. This pilot program will go into effect for tax years beginning after 1998. Under prior law, people covered by Medicare were ineligible for MSA participation.

Effective date. This provision is effective as if included in the Health Insurance Portability and Accountability Act of 1996. As a result, it applies for tax years beginning after December 31, 1996.

Act Sec. 1602(a)(2), amending Code Sec. 220(c)(3)(A); Act Sec. 1602(i). Law at ¶ 5087. Committee Report at ¶ 13,760.

Taxation of Distributions

¶ 807

Background

In addition to coverage only under a high deductible health plan and under no other health plan (except for certain types of permitted coverage), prior law also required that, during years in which medical savings account contributions are made, the person who incurred the medical expenses had to be either self-employed or employed by a small business in order for distributions from the MSA to be excludable from income.

Taxation of MSA distributions.—For any year in which a medical savings account contribution is made, MSA withdrawals are excludable from income only if the person for whom the MSA-related expenses were incurred is covered under a high deductible health plan and under no other health plan (except for certain types of permitted coverage, such as for disease-specific insurance) during the

month in which the expenses were incurred. This provision clarifies that the person who incurs a medical expense does not have to be self-employed or employed by a small business in order to exclude an MSA withdrawal for medical expenses.

Effective date. This provision is effective as if included in the Health Insurance Portability and Accountability Act of 1996. As a result, it applies for tax years beginning after December 31, 1996.

Act Sec. 1602(a)(3), amending Code Sec. 220(d)(2)(C); Act Sec. 1602(i). Law at ¶ 5087. Committee Report at ¶ 13,765.

Required Reports

¶ 811

Background

Medical savings account trustees who fail to provide required reports to the Secretary of the Treasury or to MSA account holders face a $50 penalty for each failure to provide a required report. Under prior law, a separate penalty applied for failure to provide information returns.

Failure to provide required reports for MSAs.—The $50 penalty that applies for each failure to provide required medical savings account reports does not apply to information returns described in Code Sec. 6724(d)(1)(C)(i) or to payee statements described in Code Sec. 6724(d)(2)(X).

Effective date. This provision is effective as though included in the Health Insurance Portability and Accountability Act of 1996. As a result, it is effective for tax years beginning after December 31, 1996.

Act Sec. 1602(a)(4), amending Code Sec. 6693(a); Act Sec. 1602(i). Law at ¶ 5703. Committee Report at ¶ 13,770.

Prohibited Transactions

¶ 814

Background

Under prior law, the prohibited transaction penalty exemption applied to persons for whom medical savings accounts were established only if the account ceased to be an MSA because of the Code Sec. 220(e)(2) rules.

Special exemption for MSAs.—Individuals for whom medical savings accounts are established are exempt from the 10 percent penalty (15 percent for transactions after August 5, 1997) imposed under Code Sec. 4975 on prohibited transactions if Code Sec. 220(e)(2) applies to the transaction. A requirement that the transaction is exempt from the prohibited transactions penalty only if the account ceases to be an MSA because of the Code Sec. 220(e)(2) rules has been eliminated.

Under Code Sec. 220(e)(2), an MSA loses its exempt status if the person for whom the MSA is created engages in a prohibited transaction. It also requires that, if the person for whom the MSA is created pledges all or part of the account as security for a loan, the portion so used is treated as distributed to the person. The effect of a Code Sec. 220(e)(2) violation is that any amount treated as distributed under the rules is treated as not used to pay medical expenses under the MSA.

Caution: In addition to inclusion in gross income, MSA distributions that are not used for medical purposes are still subject to a 15 percent penalty under Code Sec. 220(e)(4). Exceptions apply where distributions are made on account of death or disability. Distributions from an MSA occurring after the date the person reaches the age of Medicare eligibility are also exempt from the penalty.

Effective date. This provision is effective as if included in the Health Insurance Portability and Accountability Act of 1996. As a result, it is effective for tax years beginning after December 31, 1996.

Act Sec. 1602(a)(5), amending Code Sec. 4975(c)(4); Act Sec. 1602(i). Law at ¶ 5529.

MEDICAREPLUS CHOICE MEDICAL SAVINGS ACCOUNTS

Pilot Program

¶ 817

Background

Under prior law, individuals on Medicare were not entitled to establish a medical savings account. As a result, seniors were unable to defray unreimbursed health care expenses on a tax-favored basis through an MSA.

MedicarePlus Choice medical savings accounts (MSAs) available in pilot program.—Under prior law, individuals on Medicare were not entitled to establish a medical savings account. However, for tax years beginning after December 31, 1998, Congress has authorized a four-year pilot program that permits eligible seniors to establish MSAs called "MedicarePlus Choice MSAs." These MSAs are, in many ways, similar to the MSAs instituted by the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) in that eligible individuals, or account holders, will be able to use MSA contributions to pay health care expenses. However, MedicarePlus Choice MSAs must be used in conjunction with a high deductible MedicarePlus Choice MSA health plan ("MSA plan"). The program is a test and will be available on a first-come, first-serve basis to the first 390,000 eligible seniors. The pilot program ends December 31, 2002.

MedicarePlus Choice MSAs must meet certain legal requirements in addition to those set forth in Code Sec. 220(d), which governs non-Medicare medical savings accounts. These requirements are:

(1) The MSA must be designated as a MedicarePlus Choice MSA.

(2) Contributions must be made by the Secretary of Health and Human Services or by the trustee of another MedicarePlus Choice MSA through a trustee-to-trustee transfer (see ¶ 819).

(3) The trust document must authorize trustee-to-trustee transfers.

(4) The MSA must be established in conjunction with an MSA plan.

The trustee of the MedicarePlus Choice MSA must be either a bank, insurance company, or other person approved by the Secretary of the Treasury.

MSA plan. As noted above, a MedicarePlus Choice MSA must be established in conjunction with an MSA plan. An MSA plan is a new type of health plan that requires a certain deductible to be satisfied before a senior citizen's medical expenses are reimbursed. The amount of the annual deductible under an MSA plan

may not exceed $6,000 in 1999. This amount will be indexed for inflation thereafter.

Effective date. Provisions amending the Social Security Act are effective August 5, 1997 and apply to tax years beginning after December 31, 1998. Provisions amending the Code are effective for tax years beginning after December 31, 1998.

Act Sec. 4001 of the Balanced Budget Act of 1997, amending Title XVIII of the Social Security Act; Act Sec. 4006 of the Balanced Budget Act of 1997, amending the Internal Revenue Code of 1986 by redesignating Code Sec. 138 as Code Sec. 139 and adding a new Code Sec. 138; adding Code Sec. 220(b)(7) and amending Code Sec. 4973(d). Law at ¶ 5060, 5060A, 5087, 5527, and 7091. Committee Reports at ¶ 20,010 and 20,015.

Tax Advantages

¶ 819

Tax advantages of MedicarePlus Choice MSAs.—Under the law, the Secretary of Health and Human Services will make contributions to the MedicarePlus Choice MSAs. According to the Committee Report, these contributions are excluded from the individual's annual gross income. Further, any earnings on amounts held in an MSA are not included in taxable income for the current year.

Taxation of distributions. According to the Committee Report, distributions for qualified medical expenses incurred for the benefit of the account holder are excluded from income. Distributions are deductible regardless of whether the account holder is enrolled in an MSA plan at the time of the distribution.

However, distributions for other purposes are includible in taxable income and may even be subject to an additional penalty if they exceed a certain amount. See ¶ 825.

Certain nonmedical-related distributions do not trigger a taxable event. Under the law:

(1) a transfer of funds from one MedicarePlus Choice MSA of an account holder to another MedicarePlus Choice MSA of the same account holder (called a "trustee-to-trustee transfer") does not trigger a taxable event;

(2) contributions made in error by the Secretary and Health and Human Services may be returned to the Secretary (along with any earnings) without tax consequences to the account holder; and

(3) according to the Committee Report, after-death distributions for the qualified medical expenses of a surviving spouse or spouse's dependents are not taxable where the surviving spouse is the named beneficiary. See discussion below.

Limits on contributions. A MedicarePlus Choice MSA is an MSA as defined in Code Sec. 220(d). As such, contributions are subject to an annual limitation, which is 75 percent of the individual's deductible of the required MSA plan. As an example, the yearly contribution for an account holder that has an MSA plan with an annual deductible of $6,000 may not exceed $4,500.

Under a special formula, if the amount of the individual's MSA plan's premium is less than 1/12 of the applicable annual MedicarePlus Choice capitation rate, 100 percent of the difference will be deposited in the MSA.

Estate tax. The value of the MedicarePlus Choice MSA is included in the account holder's gross estate for estate tax purposes, according to the Committee Report.

Distributions after death. According to the Committee Report, a surviving spouse named as a beneficiary may continue the MSA for himself or herself, but no new contributions may be made. Distributions from the account for the qualified medical expenses of the surviving spouse or the spouse's dependents are not includible in income. In addition, earnings on the account balance are not includible in income. Finally, distributions that are not used for medical expenses are includible in income and are subject to an additional 15 percent tax unless made after age 65, or due to death or disability.

Caution. If the named beneficiary is not the surviving spouse, the value of the MSA as of the date of the account holder's death must be included in the taxable income of the beneficiary for the taxable year in which the death occurred. If no beneficiary is named, the value of the MSA as of the date of death must be included in the taxable income of the account holder's final income tax return.

Effective date. Provisions amending the Social Security Act are effective on August 5, 1997 and apply to tax years beginning after December 31, 1998. Provisions amending the Code are effective for tax years beginning after December 31, 1998.

Act Sec. 4001 of the Balanced Budget Act of 1997, amending Title XVIII of the Social Security Act; Act Sec. 4006 of the Balanced Budget Act of 1997, redesignating Code Sec. 138 as Code Sec. 139 and adding a new Code Sec. 138; adding Code Sec. 220(b)(7) and amending Code Sec. 4973(d). Law at ¶ 5060, 5060A, 5087, 5527, and 7091. Committee Reports at ¶ 20,010 and 20,015.

Eligibility

¶ 821

Who is eligible for a MedicarePlus Choice MSA.—MedicarePlus Choice MSAs are available to certain Medicare-eligible individuals in MedicarePlus Choice MSA plans. For the year 1999, the maximum deductible for an MSA plan is $6,000. This amount will be indexed for inflation in subsequent years.

Individuals suffering from end-stage renal disease may not enroll in an MSA plan and, therefore, may not establish a MedicarePlus Choice MSA. However, individuals who develop end-stage renal disease while enrolled in an MSA plan may continue to participate in that plan. In addition, individuals must reside in the United States for at least 183 days during any year of enrollment in an MSA plan. Availability is limited to the first 390,000 applicants.

The account holder must establish the MSA before the beginning of the month in which the Secretary of Health and Human Services is required to make contributions. Further, if the account holder has established more than one MedicarePlus Choice MSA, one account must be designated as the account for purposes of receiving contributions. According to the law, the Secretary will make lump-sum deposits of the entire yearly contribution during the first month of the MSA.

Effective date. This provision is effective on August 5, 1997 and applies to tax years beginning after December 31, 1998.

Act Sec. 4001 of the Balanced Budget Act of 1997, amending Title XVIII of the Social Security Act. Law at ¶ 7091. Committee Report at ¶ 20,010.

Distributions

¶ 823

Special rules for MSA distributions.—Monies held in MedicarePlus Choice MSAs can only be used to pay for the account holder's "qualified medical expenses," as defined in Code Sec. 213(d). Generally, amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease are considered qualified medical expenses.

Under the Conference Committee Report, distributions may not be used to pay insurance premiums, other than premiums for long-term care insurance, COBRA, or premiums for coverage while an individual is receiving unemployment compensation.

Caution. Only expenses relating to the medical care of the account holder are considered qualified medical expenses for purposes of a MedicarePlus Choice MSA. Therefore, distributions used to pay for medical expenses of the account holder's spouse, children, or other dependents will trigger a taxable event.

Effective date. This provision applies to tax years beginning after December 31, 1998.

Act Sec. 4006 of the Balanced Budget Act of 1997, redesignating Code Sec. 138 as Code Sec. 139 and adding a new Code Sec. 138; adding Code Sec. 220(b)(7) and amending Code Sec. 4973(d). Law at ¶ 5060, 5060A, 5087, and 5527. Committee Report at ¶ 20,015.

Penalties

¶ 825

When penalties apply.—To the extent that distributions for purposes other than qualified medical expenses exceed the amount by which the value of the MSA plan as of December 31 of the preceding tax year exceeds 60 percent of the deductible of the MSA plan, an additional 50 percent tax applies. However, the additional tax does not apply to distributions made on account of the disability or death of the account holder.

> **Example.** In 1999, Lauren Dwyer enrolls in a MedicarePlus Choice MSA health plan having a $3,000 deductible. As of December 31, 2000, the value of Dwyer's MSA is $2,250. In 2001, Dwyer withdraws the full amount ($2,250) from her MedicarePlus Choice MSA to pay for insurance premiums. To calculate the penalty:
>
> (1) First, determine the extent to which value of the MSA as of December 31, 2000 ($2,250), exceeds 60 percent of the plan deductible ($1,800): $450.
>
> (2) Subtract amount in (1) ($450) from the total amount of unqualified distributions ($2,250): $1,800.

In the example above, Dwyer must pay tax on the entire distribution ($2,250) since insurance premiums are not "qualified medical expenses" and an additional 50 percent tax on $1,800.

For purposes of the penalty tax, all payments and distributions not used to pay the qualified medical expenses of the account holder during any tax year are treated as one distribution. Any distribution shall be taken into account at its fair market value on the date of the distribution.

Effective date. This provision applies to tax years beginning after December 31, 1998.

Act Sec. 4006 of the Balanced Budget Act of 1997, redesignating Code Sec. 138 as Code Sec. 139 and adding a new Code Sec. 138; adding Code Sec. 220(b)(7) and amending Code Sec. 4973(d). Law at ¶ 5060, 5060A, 5087, and 5527. Committee Report at ¶ 20,015.

Reporting

¶ 827

What must be included in reports.—Trustees may be required to file reports with the Secretary of the Treasury regarding any account in accordance with Code Sec. 220(h). Such reports must disclose the fair market value of the assets in the MedicarePlus Choice MSA as of the close of each calendar year.

The reports must also be furnished to the account holders no later than January 31 of the calendar year following the calendar year to which such reports relate. According to the Committee Report, a trustee who fails to file a report without reasonable cause will be subject to a $50 penalty.

Effective date. This provision applies to tax years beginning after December 31, 1998.

Act Sec. 4006 of the Balanced Budget Act of 1997, redesignating Code Sec. 138 as Code Sec. 139 and adding a new Code Sec. 138; adding Code Sec. 220(b)(7) and amending Code Sec. 4973(d). Law at ¶ 5060, 5060A, 5087, and 5527. Committee Report at ¶ 20,015.

Limit on Number of MedicarePlus Choice MSAs

¶ 829

National limit of 390,000 seniors.—MedicarePlus Choice MSAs will be available to Medicare eligible individuals on a first-come, first-serve basis until a national limit of 390,000 is reached.

Whether an individual has established a MedicarePlus Choice MSA plan will not be taken into account when determining whether the national limits for MSAs under Code Sec. 220(j) have been exceeded.

Effective date. This provision is effective on August 5, 1997 and applies to tax years beginning after December 31, 1998.

Act Sec. 4001 of the Balanced Budget Act of 1997, amending Title XVIII of the Social Security Act. Act Sec. 4006, amending the Internal Revenue Code of 1986 by redesignating Code Sec. 138 as Code Sec. 139 and adding a new Code Sec. 138; adding Code Sec. 220(b)(7) and amending

Code Sec. 4973(d). Law at ¶ 5060, 5060A, 5087, 5527, and 7091. Committee Reports at ¶ 20,010 and 20,015.

LONG-TERM CARE INSURANCE CONTRACTS

Definition of Chronically Ill Individual

¶ 835

Background

The Code provides three alternative definitions of a "chronically ill individual" for purposes of the rules on qualified long-term care insurance. A chronically ill individual is someone who (1) is unable to perform (without substantial assistance) at least two activities of daily living for at least 90 days; (2) meets a regulatory definition of chronically ill; or (3) requires substantial supervision to protect him or her from health and safety threats due to severe cognitive impairment. Under prior law, a contract was not treated as a qualified long-term care insurance contract unless a determination of whether an individual is chronically ill took into account at least five activities of daily living. The five-activity requirement appeared to apply to determine whether a person was a chronically-ill person under all three alternative definitions of a chronically-ill individual.

Activities of daily living requirement.—For purposes of the qualified long-term care insurance rules, the rule requiring that at least five "activities of daily living" be taken into account applies only for purposes of the first of the alternative definitions of a "chronically ill individual"—the definition characterizing as chronically ill any individual who is unable to perform at least two activities of daily living for at least 90 days due to a loss of functional capacity.

The Act clarifies that the "consideration of at least five activities of daily living" requirement does *not* apply for purposes of the other two alternative definitions in the chronically ill individual test (i.e., the severe cognitive impairment requirement or the regulatory alternative).

Effective date. This provision is effective as if it had been included in the Health Insurance Portability and Accountability Act of 1996. As a result, it is effective for contracts issued after December 31, 1996.

Act Sec. 1602(b), amending Code Sec. 7702B(c)(2)(B). Act Sec. 1602(i). Law at ¶ 5747. Committee Report at ¶ 13,815.

Self-Employed Persons

¶ 837

Background

Under prior law, the self-employed health insurance deduction was not available for months in which a person was eligible to participate in any employer-provided health plan. For long-term care insurance, only eligible long-term care premiums could be taken into account for determining the deduction for self-employed health insurance.

Deduction of premiums.—The Act clarifies that the fact that a person is eligible for employer-provided health insurance does not affect that person's ability to deduct long-term care insurance premiums as long as he or she is not eligible for

employer-provided long-term care insurance. The effect of this provision is to treat a self-employed person's health insurance deduction separately with regard to (1) plans that provide long-term care insurance and (2) plans that do not provide long-term care insurance.

Effective date. This provision is effective as if included in the Health Insurance Portability and Accountability Act of 1996. As a result, it is effective for tax years beginning after December 31, 1996.

Act Sec. 1602(c), amending Code Sec. 162(l)(2)(B). Act Sec. 1602(i). Law at ¶ 5067. Committee Report at ¶ 13,820.

Reporting Requirements

¶ 839

Background

A payer of long-term care benefits is required to report to the IRS the total amount of benefits paid as well as the name, address, and taxpayer identification number of the person to whom the benefits were paid as well as for the chronically ill individual for whom the benefits were paid. Under prior law, only the name of the person making the payments, rather than the name, address, and phone number of such person, was also required to be included.

Address and phone number required.—For purposes of the reporting requirements for qualified long-term care insurance, the name, address, and phone number of the information contact of the person making the long-term care payments must be included. Under prior law, only the name of the person making the payments, rather than the name, address, and phone number of such person, was required to be included.

Effective date. This provision is effective as if included in the Health Insurance Portability and Accountability Act of 1996. As a result, it is effective for benefits paid after December 31, 1996.

Act Sec. 1602(d), amending Code Secs. 6050Q(b)(1), 6652(e), and 6724(d)(2). Act Sec. 1602(i). Law at ¶ 5607, 5691, and 5711. Committee Report at ¶ 13,825.

Consumer Protection Provision

¶ 841

Background

A long-term care insurance contract's nonforfeiture provision must provide for a benefit available in the event of a premium payment default. Under prior law, any subsequent benefit adjustment could be made only as necessary to reflect changes in claims, persistency, and interest as reflected in any premium rate changes approved by Secretary of the Treasury for the same form of contract.

State regulatory authority approval required.—A long-term care insurance contract's nonforfeiture provision must provide for a benefit available in the event of a premium payment default. Any subsequent benefit adjustment may be made only as necessary to reflect changes in claims, persistency, and interest as

reflected in any premium rate changes approved by state regulatory authorities, rather than by the Secretary of the Treasury, for the same form of contract.

Effective date. This provision is effective as if included in the Health Insurance Portability and Accountability Act of 1996. As a result, it is effective for contracts issued after December 31, 1996.

Act Sec. 1602(e), amending Code Sec. 7702B(g)(4)(B); Act Sec. 1602(i). Law at ¶ 5747. Committee Report at ¶ 13,830.

COMPANY-OWNED LIFE INSURANCE

Premiums and Interest

¶ 845

Background

Under prior law, under the company-owned life insurance (COLI) rules, deductions for premiums paid on or interest paid or accrued on indebtedness with respect to life insurance were only denied when the policy covered the life of an officer, employee, or person financially interested in any trade or business carried on by the taxpayer (and the taxpayer was directly or indirectly a beneficiary of the policy). Further, prior law did not restrict the deductions for interest on debt that funded the tax-free buildup of life insurance contracts.

Premium deduction limitations.—No deduction is permitted for premiums paid on any life insurance policy, annuity or endowment contract if the taxpayer is directly or indirectly a policy beneficiary. However, this limitation on company-owned life insurance (COLI) does not apply to premiums paid on annuity contracts for certain qualified pension plans, retirement annuities, individual retirement annuities, and qualified funding assets (under Code Sec. 72(s)(5)). Also, it does not apply to annuity contracts held by a person who is not a natural person (under Code Sec. 72(u)).

Interest deduction limitation. No deduction is allowed for interest paid or accrued on indebtedness with respect to any life insurance policy or annuity contract covering the life of any individual in whom the taxpayer has an insurable interest. For example, a mortgage lender that buys a life insurance policy on the life of a borrower will no longer be able to deduct the premiums or any interest incurred in obtaining the coverage. Further, as added by the Conference Committee, in the case of a transfer for valuable consideration of a life insurance contract, the amount of a death benefit excluded from gross income may not exceed an amount equal to the sum of the actual value of the consideration, premiums, interest disallowed under this new provision, and other amounts subsequently paid by the transferee. Under this change, in the case of the transfer for value of a life insurance contract, the interest with respect to the contract that otherwise would be disallowed under new Code Sec. 264(a)(4) is capitalized, reducing the amount included in income by the transferee upon receipt by the transferee of the amounts paid by reason of the death of the insured.

Pro rata interest disallowance. In the case of a taxpayer other than a natural person, no deduction is allowed for the portion of the taxpayer's interest expense that is allocable to unborrowed policy cash surrender values. Interest expense is allocable based on the ratio of (1) the taxpayer's average unborrowed policy cash values of life insurance policies and annuity and endowment contracts, issued after

June 8, 1997, to (2) the sum of (a) the average unborrowed policy cash values of life insurance policies or annuity or endowment contracts that are assets of the taxpayer, and (b) the average adjusted bases of all other assets of the taxpayer.

"Unborrowed policy cash value" means the cash surrender value of the policy or contract (determined without regard to any surrender charge), reduced by the amount of any loan with respect to the policy or contract.

Exceptions. The new law expands the interest deduction to certain COLI policies. The interest disallowance rule does not apply to any policy or contract owned by an entity engaged in a trade or business, that covers only one individual who (at the time first covered by the policy or contract) is either a 20-percent owner of the entity or an individual who is not a 20-percent owner but who is an employee, officer, or director of the trade or business. The only instance of where this exception applies to a policy with more than one insured is in the case of a joint-life policy for a 20-percent owner and his or her spouse. Any policy or contract that falls within the exception (or an annuity contract held by a person who is not a natural person) is not taken into account in determining unborrowed policy cash values, which in turn affects the allocation of deductible interest.

Further, if a trade or business (other than a sole proprietorship or a trade or business of performing services as an employee) is directly or indirectly the beneficiary under any policy or contract, then the policy or contract is treated as held by the trade or business. In order to carry out this trade or business treatment, the IRS will require information reporting from policyholders and issuers as necessary. In the case of a partnership or S corporation, the provision applies at the partnership or corporate level.

Other disallowance provisions. If interest expense is disallowed under other provisions of Code Sec. 264 (limiting interest deductions with respect to life insurance policies or endowment or annuity contracts) or under Code Sec. 265 (relating to tax-exempt interest), then it is not taken into account under this provision, and the average adjusted bases of assets is reduced by the amount of debt, the interest on which is so disallowed. The provision is applied before present law rules relating to capitalization of certain expenses where the taxpayer produces property (Code Sec. 263A).

Insurance companies. The pro rata allocation rules under Code Sec. 264(f) do not apply to any insurance company subject to tax under subchapter L of the Code. Rather, the rules reducing certain deductions for losses incurred, in the case of property and casualty companies, and reducing reserve deductions or dividends received deductions of life insurance companies, are modified to take into account the increase in cash values of life insurance policies or annuity or endowment contracts held by insurance companies. The increase in cash value is the amount of the increase in the adjusted cash value (commissions, asset management fees, surrender and mortality charges, and other fees imposed), reduced by gross premiums, and increased by distributions under the policy other than amounts includible in the policyholder's gross income.

Effective date. The provisions apply with respect to contracts issued after June 8, 1997, in tax years ending after that date. Any material increase in the death benefit or other material change in the contract causes the contract to be treated as a new contract, but the addition of covered lives is treated as a new contract only with respect to the additional covered lives. An increase in the death benefit of a policy or contract issued in connection with a lapse described in section

501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 is not treated as a new contract.

Act Sec. 1084(a)(1), amending Code Sec. 264(a)(1); Act Sec. 1084(a)(2), amending Code Sec. 264 by redesignating subsections (b), (c) and (d) as (c), (d) and (e), respectively, and adding new Code Sec. 264(b); Act Sec. 1084(b)(1), amending Code Sec. 264(a)(4); Act Sec. 1084(b)(2), amending Code Sec. 101(a)(2); Act Sec. 1084(c), adding Code Sec. 264(f); Act Sec. 1084(b)[d](1)(A), amending Code Sec. 805(a)(4)(C)(ii); Act Sec. 1084(b)[d](1)(B), amending Code Sec. 805(a)(4)(D)(iii); Act Sec. 1084(b)[d](1)(C), adding Code Sec. 805(a)(4)(F); Act Sec. 1084(b)[d](2)(A), amending Code Sec. 807(a)(2)(B); Act Sec. 1084(b)[d](2)(B), amending Code Sec. 807(b)(1)(B); Act Sec. 1084(b)[d](3), adding Code Sec. 812(d)(1)(D); Act Sec. 1084(b)[d](4), adding Code Sec. 832(b)(5)(B)(iii); Act Sec. 1063(c)[e], amending Code Sec. 265(b)(4)(A); Act Sec. 1063(d)[f]. Law at ¶ 5043, 5097, 5099, 5247, 5249, 5251, 5257. Committee Report at ¶ 11,530.

Former Officers, Employees or Interests

¶ 848

Background

No deduction is allowed for interest paid or accrued on indebtedness with respect to life insurance policies, or annuity or endowment contracts purchased by businesses, on the lives of certain individuals. The rule covers an individual who (1) *is* an officer or employee of, or (2) *is* financially interested in, the business (the company-owned life insurance (COLI) rule). Prior to the Taxpayer Relief Act of 1997, it was unclear whether the rule covered former officers or employees, or individuals who formerly had a financial interest in the business.

Former officers, employees or interests.—No deduction is allowed for interest paid on indebtedness with respect to life insurance policies or annuity or endowment contracts purchased by businesses on the lives of officers or employees of the business, or individuals with a financial interest in the business (the company-owned life insurance (COLI) provision).

A technical correction makes it clear that the COLI rule applies not only to individuals who are *currently* officers or employees, or who *currently* have a financial interest in the business, but also to anyone who *was* an officer or employee or *formerly* had a financial interest in the business. The correction thus clarifies the treatment of interest on debt with respect to contracts covering former employees of the taxpayer and with respect to a business formerly conducted by the taxpayer and transferred to an affiliate of the taxpayer.

Effective date. Effective with respect to interest paid or accrued after October 13, 1995, generally.

Act Sec. 1602(f)(1), amending Code Sec. 264(a)(4). Law at ¶ 5097. Committee Report at ¶ 13,845.

Applicable Period Election

¶ 851

Background

The COLI provision is generally inapplicable to interest on debt with respect to contracts purchased before June 21, 1986. If a contract entered into before this date has a variable interest rate, the amount of interest that is deductible after December 31, 1995, is limited. The deduction is allowable only to the extent that the rate of interest for each fixed period does not exceed Moody's Corporate Bond Yield Average—Monthly Average Corporates, for the third month preceding the first month of the fixed period. The maximum length of the fixed period is 12 months. Prior to the Taxpayer Relief Act of 1997, there was no rule specifying the time requirement for electing the fixed period during which the applicable interest rate limitation would apply or specifying the applicable period if no election was made.

Variable rate contracts.—The GOLI provision, denying interest deductions on company-owned life insurance, generally does not apply to interest on debt with respect to contracts purchased before June 21, 1986. If such a contract provides for a variable interest rate, the amount of interest that is deductible is limited to the extent that the rate of interest for each fixed period selected by the taxpayer does not exceed Moody's Corporate Bond Yield Average—Monthly Average Corporates, for the third month preceding the first month of the fixed period. The fixed period may not exceed 12 months.

A technical correction now requires that the election of a fixed period during which the applicable interest rate limitation will apply can be made no later than the 90th day after August 5, 1997 (November 3, 1997) and if made applies to the taxpayer's first tax year ending on or after October 13, 1995 and all subsequent tax years, unless revoked with the consent of the Secretary. If no election is made, the applicable period is the policy year. The policy year is the 12-month period beginning on the anniversary date of the policy.

Effective date. Effective with respect to interest paid or accrued after October 13, 1995, generally.

Act Sec. 1602(f)(2), amending Code Sec. 264(d)(2)(B)(ii). Law at ¶ 5097. Committee Report at ¶ 13,850.

Key Person Exception

¶ 854

Background

There is an exception in the COLI rule for interest on indebtedness with respect to life insurance policies covering up to 20 key persons. The term "key person" means an officer or 20-percent owner of a business. The number of individuals who can be treated as key persons with respect to any business may not exceed the greater of (1) five individuals or (2) the lesser of five percent of the total officers and employees of the business or 20 individuals. In the case of a corporation, a "20-percent owner" is any person who owns directly 20 percent or more of the total combined voting power of the corporation. Prior to the Taxpayer Relief

Background

Act of 1997, if the taxpayer was not a corporation, a 20-percent owner was defined as anyone who owned 20 percent or more of the capital or profits interest of the *employer.*

Definition of 20-percent owner.—There is an exception to the COLI rule for interest on indebtedness with respect to life insurance policies covering up to 20 key persons. A "key person" is an individual who is either an officer or a 20-percent owner of the taxpayer. Prior law provided that in the case of a taxpayer that was not a corporation, a 20-percent owner was an individual who owned 20 percent or more of the capital or profits interest of the *employer.* The technical correction clarifies this definition by changing the word *employer* to *taxpayer.*

Effective date. Effective with respect to interest paid or accrued after October 13, 1995, generally.

Act Sec. 1602(f)(3), amending Code Sec. 264(d)(4)(B). Law at ¶ 5097. Committee Report at ¶ 13,855.

Effective Date

¶ 857

Background

The COLI rule, denying interest deductions on company-owned life insurance (COLI), generally does not apply to interest on debt with respect to contracts purchased on or before June 20, 1986. The interest deductible on contracts purchased before this date may be limited under an interest cap provision, however. Prior to the Taxpayer Relief Act of 1997, it was not clear whether the cap applied to interest on such a contract paid or accrued after December 31, 1995, or after October 13, 1995.

Interest rate cap.—The COLI rule generally does not apply to interest on debt with respect to contracts purchased on or before June 20, 1986. If such a contract has a variable interest rate, it is subject to an interest rate cap. Although Code Sec. 264(d)(2) provided that this cap applies to interest paid or accrued after December 31, 1995, Code Sec. 264(d)(2)(B) provided that the cap applied to interest paid or accrued after October 13, 1995. A technical correction eliminates the discrepancy and makes it clear that the applicable date is December 31, 1995.

Effective date. Effective with respect to interest paid or accrued after December 31, 1995.

Act Sec. 1602(f)(4), striking section 501(c)(3) of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191). Law at ¶ 7079. Committee Report at ¶ 13,860.

Contract Lapses

¶ 861

Background

In addition to the general nondeductibility rule, the COLI rules impose additional limitations on the deductibility of two special kinds of interest: (1) interest on single premium contracts; and (2) interest on debt incurred to purchase

Background

or carry a life insurance, endowment, or annuity contract pursuant to a plan of purchase that contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of the contract. However, there is an exception to the second limitation. Interest on bona fide debt that is part of such a plan may be deducted if no part of four of the annual premiums due during the first seven years is paid by means of debt (the 4-out-of-7 rule).

The lapse of a contract after October 13, 1995, due to nonpayment of premiums does not cause interest paid or accrued before January 1, 1999, to be nondeductible solely by reason of a failure to meet the 4-out-of-7 rule or cause the contract to be treated as a single premium contract. Prior to the Taxpayer Relief Act of 1997, the lapse provision incorrectly stated, however, that the relief was provided solely by reason of "no *additional premiums* being received because of a *lapse*."

Contract lapses.—Under the COLI rules, special limitations are imposed on the deductibility of interest with respect to single premium contracts and interest on debt incurred or continued to purchase or carry a life insurance, endowment, or annuity contract pursuant to a plan of purchase that contemplates the systematic direct or indirect borrowing of part or all of the increases in cash value of the contract. This borrowing rule is subject to an exception permitting deductibility of interest on bona fide debt that is part of such a plan if no part of four of the annual premiums due during the first seven years is paid by means of debt (the 4-out-of-7 rule).

A technical correction makes it clear that under the transition relief provision, the 4-out-of-7 rule and the single premium rule of present law are not to apply solely by reason of a lapse occurring after October 13, 1995, by reason of no additional premiums being received under the contract.

Effective date. Effective with respect to interest paid or accrued after October 13, 1995, generally.

Act Sec. 1602(f)(5), amending section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191). Law at ¶ 7079. Committee Report at ¶ 13,865.

SELF-EMPLOYED HEALTH INSURANCE

Deduction Increase

¶ 863

Background

The amount of the deduction for health insurance costs of self-employed individuals was scheduled to be phased in starting with tax years beginning in 1997, reaching a maximum deductible percentage of 80 percent in 2006 and later years.

Phase-in of deduction accelerated.—Self-employed individuals may deduct as a trade or business expense, a specified percentage of the health insurance costs incurred during the tax year for themselves, their spouses, and their dependents.

Prior to enactment of the Taxpayer Relief Act of 1997 the deductible percentage was scheduled to be phased in for tax years beginning in the listed years as follows:

1997	40%
1998 through 2002	45%
2003	50%
2004	60%
2005	70%
2006 and thereafter	80%

The phase-in schedule has been accelerated and the eventual top rate increased to 100 percent. The deductible percentage, for tax years beginning in the calendar years listed, is as follows:

1997	40%
1998 and 1999	45%
2000 and 2001	50%
2002	60%
2003 through 2005	80%
2006	90%
2007 and thereafter	100%.

Effective date. The provision applies to tax years beginning after December 31, 1996.

Act Sec. 934(a), amending Code Sec. 162(l)(1)(B); Act Sec. 934(b). Law at ¶ 5067. Committee Report at ¶ 10,670.

GROUP HEALTH PLANS

Penalty for Violating Maternity Stay and Mental Health Parity Rules

¶ 865

Background

The Newborns' and Mothers' Health Protection Act of 1996 imposed length-of-hospital stay mandates on group health plans with regard to coverage of newborns and mothers. The Mental Health Parity Act of 1996 imposed rules on coverage of mental health benefits by group health plans. Under prior law, these rules were included only in the Employee Retirement Income Security Act (ERISA) and the Public Health Service Act. Employers whose group health plans failed to comply with the maternity length-of-stay mandates or with the mental health parity rules were not subject to the $100 per day per affected individual penalty imposed by Code Sec. 4980D for failures to comply with the group health plan rules.

Implementation of maternity stay mandates and mental health parity legislation.—The Act incorporates into the Code provisions of the Newborns' and Mothers' Health Protection Act of 1996 (P.L. 104-204) and the Mental Health Parity Act of 1996 (P.L. 104-204) relating to group health plans. Under prior law, these provisions were included only in the Employee Retirement Income Security Act (ERISA) and the Public Health Service Act.

Employers whose group health plans fail to comply with the maternity stay mandates or with the mental health parity rules are now subject to the Code Sec. 4980D penalty of $100 per day per affected individual.

Length of maternity stay mandates. Under the federal maternity stay mandate, group health plans are barred from restricting postpartum hospital stays, for a mother and her newborn baby, to less than 48 hours following a normal delivery

and 96 hours following a caesarean section. An attending health care provider, in consultation with the mother, can approve an earlier discharge. However, a group health plan cannot provide monetary incentives for the mother or the health care provider to reduce the minimum stay.

The federal length-of-stay mandate applies to both insured and self-insured health plans. However, it does not apply to health plans that do not provide benefits for hospital stays in connection with childbirth for a mother and her newborn baby. In addition, the federal mandate does not preempt state laws that provide more favorable treatment with regard to length of postpartum hospital stay.

Mental health parity requirements. Group health plans that have lifetime or annual limits on what the plans will spend for medical or surgical services must either include services for mental illness in their total limit or maintain a separate limit for mental illness that is no more restrictive than the medical/surgical limit. The mental health parity provision does not require health plans to offer mental health coverage nor does it affect a health plan's flexibility to affect the terms and conditions relating to the amount, scope, or duration of mental health coverage.

Businesses with 50 or fewer employees are exempt from the mental health parity rules. An exemption also applies if the mental health parity rules would increase the health plan's costs by more than one percent.

Penalties. A $100 per day penalty is imposed, under Code Sec. 4980D, on employers whose group health plans fail to comply with the maternity length-of-stay mandates or the mental health parity provisions. The penalty is imposed for each day a failure occurs, until it is corrected, and applies separately for each individual affected by the failure to comply. However, no penalty is imposed if the failure to comply is unintentional and corrected within 30 days after it is discovered (or should have been discovered). The penalty is limited, for unintentional failures, to the lesser of (1) 10 percent of the group health plan's expenses for the prior year or (2) $500,000 per tax year.

Small employers (i.e., those that employ, on average, 50 employees or less) are exempted from the penalty for failures involving the mental health parity provision. However, these small employers remain subject to the penalty for failure to comply with the maternity length-of-stay requirement.

Effective date. The provisions are effective for group health plans for plan years beginning on or after January 1, 1998. The mental health parity provision will not apply to benefits for services furnished on or after September 30, 2001.

Act Sec. 1531(a), adding Code Secs. 9811 and 9812 and redesignating Code Secs. 9804, 9805, and 9806 as Code Secs. 9831, 9832, and 9833, respectively; Act Sec. 1531(b), amending Code Secs. 4980D, 9801, and 9831 (as redesignated); Act Sec. 1531(c). Law at ¶ 5537 and 5759–5771. Committee Report at ¶ 13,455.

Church Plans

¶ 867

Background

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) enacted an excise tax applicable to group health plans that failed to satisfy a nondiscrimination rule. This rule provided that group health plans may not

Background

establish rules for eligibility based on eight factors relating to an individual or dependent of the individual. These factors are: (1) health status, (2) medical condition, (3) claims experience, (4) receipt of health care, (5) medical history, (6) genetic information, (7) evidence of insurability, or (8) disability. The excise tax is imposed on the employer sponsoring the plan and is equal to $100 per day per individual as long as the plan is not in compliance.

Church plan exception to discrimination prohibition based on health. Church plans are exempted from the Health Insurance Portability and Accountability Act of 1996 rule barring discrimination based on health status factors. Under this exemption qualified church plans do not violate the nondiscrimination requirement merely because the plan requires evidence of good health in order for an individual to enroll in the plan for: (1) individuals who are employees of employers with 10 or fewer employees and for self-employed individuals, or (2) an individual who enrolls after the first 90 days of eligibility under the plan.

In order to qualify for this exception, the church plan must have included a provision requiring evidence of good health on July 15, 1997, and at all times thereafter before the beginning of the year.

Effective date. This special rule is effective as if included in the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) and generally applies to plan years beginning after June 30, 1997.

Act Sec. 1532(a) adding Code Sec. 9802(c). Act Sec. 1532(b). Law at ¶ 5761. Committee Report at ¶ 13,465.

Chapter 9

Foreign Taxpayers and Investments

FOREIGN TAX CREDIT

Translation of Foreign Taxes

¶ 901

Background

Foreign income taxes (including estimated tax and withholding taxes) paid in foreign currency are translated into U.S. dollars using daily exchange rates based on the date that taxes are paid. This rule applies to both foreign taxes paid directly by a U.S. taxpayer and to taxes paid by foreign corporations that are indirectly deemed paid, for U.S. tax purposes, by a U.S. shareholder.

If the U.S. taxpayer uses the accrual method of accounting for determining creditable foreign taxes, accrued but unpaid foreign income tax liabilities denominated in foreign currency may need to be taken into account in order to compute the taxpayer's foreign tax credit and determine its U.S. tax liability. In such situations, the amount of foreign tax subsequently paid could differ from the tax previously accrued, resulting in a redetermination of foreign tax. A redetermination can arise in basically three situations: (1) a refund of foreign tax or credit allowed against foreign tax; (2) the amount of tax (in foreign currency) actually paid differs from the amount of tax (in foreign currency) accrued; and (3) the U.S. dollar value of foreign tax paid differs from foreign tax accrued due to currency fluctuations.

Where circumstances require redetermination of foreign tax, the taxpayer must notify the IRS, which will then redetermine the taxpayer's U.S. tax liability. In the case of foreign taxes for which an indirect foreign tax credit is claimed, taxpayers must make appropriate adjustments to the payor foreign corporation's pools of earnings and profits and foreign taxes.

Prior to the Act, accrued but unpaid foreign taxes were translated into dollars using the exchange rate for the last day of the tax year in which such taxes were accrued. Also, under prior law, the last type of redetermination, i.e., one caused by currency fluctuation, was not required for certain *de minimis* changes in the amount of foreign tax, but was required for redetermined amounts above the *de minimis* threshold.

Average exchange rate may be used for currency translation of accrued foreign taxes.—Taxpayers that, for foreign tax credit purposes, account for foreign taxes on an accrual basis generally may translate foreign income taxes accrued into U.S. dollars at the average exchange rate for the tax year to which the taxes relate. This rule does not apply to (1) foreign taxes actually paid more than two years from the close of such tax year; (2) foreign taxes actually paid in a tax year prior to the year to which they relate; and (3) taxes paid in an inflationary currency, as defined by regulations.

All foreign taxes not eligible for translation at the yearly average exchange rate must be translated using the exchange rate for date of payment. However, the Act gives regulatory authority to the Treasury to specify periodic average exchange rates that may be used instead of actual daily exchange rates.

Congress stated that the change in the law should simplify the translation of foreign taxes by reducing the number of translation calculations required and the number of instances in which a subsequent adjustment or redetermination of

accrued foreign taxes will be necessary in computing the taxpayer's foreign tax credit.

Redetermination of foreign taxes. As under prior law, where foreign tax paid differs from accrued amounts or if tax paid is refunded in whole or in part, the taxpayer is required to notify the IRS, which will redetermine the taxpayer's U.S. tax liability pursuant to Temp. Reg. § 1.905-4T. The Act provides that a redetermination will also occur anytime that accrued foreign taxes remain unpaid for more than two years after the close of the tax year to which the taxes relate. Unlike prior law, however, if the foreign tax is paid within the two-year period, no redetermination is necessary even though the actual dollar value of the foreign tax paid may differ from the accrued amount due to currency fluctuations. Also, the Act provides that, in lieu of redetermining foreign tax for purposes of an indirect credit, under regulations to be promulgated by the Treasury, adjustments may be made to the payor foreign corporation's pools of earnings and profits and foreign taxes.

Example (1). USA Co. is a domestic corporation with a branch in Canada. In Year 1, USA Co. accrues Canadian income tax of CAN$138,000 that remains unpaid at the close of Year 1. Using the average exchange rate for Year 1 of 1.38:1, USA Co. claims a U.S. foreign tax credit of US$100,000. Before the close of Year 3, USA Co. pays all but CAN$13,800 in Canadian tax. No redetermination of its foreign tax paid in Year 1 is required with respect to the amounts paid before the end of Year 3. However, the accrual of CAN$13,800 that remains unpaid at the close of Year 3 is now disallowed, and USA Co. must reduce its foreign tax credit for Year 1 by US$10,000.

Redetermined taxes paid are generally translated into U.S. dollars using the exchange rate applicable on the date the foreign taxes are paid. This rule also applies to accrued taxes paid after the two-year period. Where foreign taxes are refunded or credited by the foreign government, the redetermined amount of taxes paid is translated into dollars using the exchange rate as of the date of the original payment of such taxes.

Accrued taxes paid after two-year period. For accrued taxes paid after the two-year period, the Act provides that, if the taxpayer claimed a direct foreign tax credit, the payment is taken into account for the tax year to which the foreign tax relates. If an indirect credit was taken, foreign tax subsequently paid is taken into account in determining the taxpayer's foreign tax credit for the tax year in which the tax was paid.

Example (2). Assume the facts of Example 1, above. In Year 4, USA Co. pays its remaining Canadian tax liability of CAN$13,800 for Year 1. USA Co. again redetermines its foreign taxes (and foreign tax credit) in Year 1 using the exchange rate in effect on the date of payment. If, however, USA Co. had a Canadian subsidiary rather than a branch and had claimed an indirect foreign tax credit with respect to the subsidiary's Canadian income tax, the payment in Year 4 would be taken into account in determining USA Co.'s foreign tax credit in Year 4, and a second redetermination of Year 1 foreign taxes would not occur.

PRACTICAL ANALYSIS. Paul Bodner, Esq., Great Neck, N.Y., observes that even in the computer age, the foreign tax credit computation is extremely burdensome for multinational corporations. Because foreign taxes are paid after year end, the require-

ment to translate foreign income taxes on the payment rather than the accrual date adds considerable complications. The requirement to redetermine credits in other than *de minimis* cases not only causes Federal complications, but because Federal taxable income is typically the starting point for State taxation, a Federal redetermination usually requires State redeterminations. For the typical large corporation, this State compliance burden is even larger than the Federal burden. Although one can quibble with the details, this simplification eases the compliance burden. The modification that indirect foreign taxes paid more than two years after the accrual year are creditable in the year the tax is paid simplifies compliance, but is likely to aggravate the foreign tax credit limitation problem.

Effective date. The provisions governing translation of foreign taxes apply to taxes paid or accrued in tax years beginning after December 31, 1997. The provision concerning redetermination of foreign taxes applies to taxes which relate to tax years beginning after December 31, 1997.

Act Sec. 1102(a)(1) and (b)(1), amending Code Sec. 986(a); Act Sec. 1102(a)(2), amending Code Sec. 905(c); Act Sec. 1102(b)(2), amending Code Sec. 989(c); Act Sec. 1102(b)(3), amending Code Sec. 989(b); Act Sec. 1102(c). Law at ¶ 5289, 5309, and 5313. Committee Report at ¶ 11,620.

Exemption from FTC Limitation for Certain Individuals

¶ 904

Background

Under Code Sec. 904, the tax credit of individuals and corporations for foreign taxes paid or accrued (or deemed paid or accrued) is generally limited to the precredit U.S. federal income tax that is attributable to foreign source income. This overall foreign tax credit (FTC) limitation is complicated immensely by a system of separate income categories that must be used in computing a separate FTC limitation for each category.

The separate categories are designed to prevent "cross-crediting" of active foreign business income from high-tax foreign jurisdictions against lower taxed passive income from other foreign sources. Taxpayers are required to compute foreign source .taxable income and foreign taxes paid in each of the applicable separate FTC limitation categories. Prior to the Act, individuals were required to make these calculations and reflect the results on Form 1116 in order to claim a foreign tax credit, regardless of the amount of their foreign tax credit claimed.

Exemption from FTC limitation rules for individuals with *de minimis* foreign tax credits.—An individual with $300 or less of creditable foreign taxes is exempt from the foreign tax credit (FTC) limitation, provided he has no foreign source income other than qualified passive income. The $300 amount is increased to $600 for joint filers.

The exemption is not automatic. To qualify, an individual must elect to take the exemption for the tax year.

Congress believed that numerous taxpayers were in a situation in which the amount of their foreign tax paid and corresponding tax credit was small but their

reporting burden was substantial due to the complexities of completing Form 1116 (Foreign Tax Credit) and allocating foreign income among the separate FTC limitation categories. Accordingly, it enacted the simplification measure. The Conference Committee anticipates that individuals electing exemption from the FTC limitation will not be required to file Form 1116 in order to claim a foreign tax credit.

Passive income defined. As mentioned above, the exemption is only available to taxpayers whose foreign source income consists solely of passive income. Qualified passive income includes all types of income that is the foreign personal holding company income under the controlled foreign corporation rules of Code Sec. 954(c) plus certain income inclusions from foreign personal holding companies and passive foreign investment companies. In general, the term refers primarily to investment income, such as dividends, interest, rents, royalties, annuities and exchange gains. Qualified passive income must be shown on a payee statement furnished to the taxpayer.

Restrictions. An individual electing exemption from the FTC limitation rules may not carry over any excess foreign taxes paid or accrued to or from a tax year to which the election applies. Also, for purposes of the election, creditable foreign taxes are limited to those shown on a payee statement furnished to the taxpayer. Finally, the election is not available to estates or trusts.

Effective date. This provision applies to tax years beginning after December 31, 1997.

Act Sec. 1101, redesignating Code Sec. 904(j) as Code Sec. 904(k) and adding new Code Sec. 904(j). Law at ¶ 5287. Committee Report at ¶ 11,615.

Simplified AMT Limitation

¶ 907

Background

Prior to the Taxpayer Relief Act of 1997, to calculate the foreign tax credit limitation for purposes of the alternative minimum tax (AMT), a taxpayer was required to take deductions that were allocated and apportioned for regular tax purposes and reallocate and reapportion the deductions for AMT purposes. The foreign tax credit limitation fraction used was the ratio of the foreign source *alternative minimum* taxable income to the entire alternative minimum taxable income.

Simplified AMT foreign tax credit limitation election.—Taxpayers may elect to use a simplified alternative minimum tax (AMT) foreign tax credit limitation when calculating their AMT foreign tax credit. The simplified limitation is the ratio of the taxpayer's foreign source *regular* taxable income to the entire alternative minimum taxable income (AMTI). Because the simplified limitation uses foreign source regular taxable income, rather than foreign source AMTI, the taxpayer is not required to reallocate and reapportion deductions for AMT purposes.

The AMT foreign tax credit limitation under the simplified method is computed using the following formula:

Foreign source regular taxable income ÷ Worldwide AMTI × AMT rate (Worldwide AMTI − AMT exemption)

Foreign source regular taxable income, as used in the simplified limitation, cannot exceed the taxpayer's entire AMTI. If it does exceed AMTI, it is the Conference Committee's intent that foreign source taxable income in each foreign tax credit limitation category be reduced by a pro rata portion of the excess.

The election may be made only in the taxpayer's first tax year beginning after December 31, 1997, for which the taxpayer claims an AMT foreign tax credit. The election applies to all subsequent tax years and can be revoked only with the consent of the IRS.

Example. Americo Corp. has worldwide AMTI of $95,000. Its tentative minimum tax, before subtracting an AMT foreign tax credit is equal to 20% × ($95,000 − $40,000) = $11,000. From its operations in country M, Americo had $30,000 of foreign source taxable income, and from its operations in country T, Americo had $20,000 of foreign source taxable income. Americo's taxable income from foreign sources is $50,000 ($20,000 + $30,000). Americo's foreign tax credit limitation is ($50,000 ÷ $95,000) × $11,000 = $5,789.

PRACTICAL ANALYSIS. Paul Bodner, Esq., Great Neck, N.Y., notes that the election is available only in the first taxable year beginning after December 31, 1997 for which the taxpayer claims an AMT foreign tax credit. Because this simplification provision is primarily of value to individuals, this requirement will create difficulties in later years, if taxpayers are not permitted to make this election. It creates an opportunity for professional tax preparers to be criticized for negligence if the election, or failure to make the election, proves to be costly in later years. For large corporations, because AMT foreign source income is typically larger than regular taxable income, this election will not be made.

Effective date. The provision applies to tax years beginning after December 31, 1997.

Act Sec. 1103(a), adding Code Sec. 59(a)(3)[(4)]; Act Sec. 1103(b). Law at ¶ 5035. Committee Report at ¶ 11,625.

AMT Limitation Exception Repealed

¶ 910

Background

The alternative minimum foreign tax credit (AMT-FTC) may not offset more than 90 percent of a taxpayer's pre-credit tentative minimum tax. The pre-credit tenative minimum tax is calculated without regard to the alternative tax net operating loss deduction and the rule under Code Sec. 57(a)(2)(E) that limits benefits from the repeal of the intangible drilling cost preference. Prior to the Taxpayer Relief Act of 1997, the 90-percent limitation did not apply in the case of certain domestic corporations that met specific requirements.

Repeal of corporate exception from AMT-FTC limitation.—The rule that excepts certain domestic corporations from the limitation on the use of foreign tax credits for alternative minimum tax purposes is repealed. Accordingly, the alternative minimum foreign tax credit (AMT-FTC) may not offset more than 90 percent of an individual or corporate taxpayer's pre-credit tentative minimum tax.

The pre-credit tentative minimum tax is calculated without regard to the alternative tax net operating loss deduction and the rule under Code Sec. 57(a)(2)(E) that limits benefits from the repeal of the intangible drilling cost preference.

Effective date. The amendment applies to tax years beginning after August 5, 1997.

Act Sec. 1057(a), striking Code Sec. 59(a)(2)(C); Act Sec. 1057(b). Law at ¶ 5035. Committee Report at ¶ 11,395.

Financial Services Income Limitation

¶ 912

Background

For purposes of determining the foreign tax credit limitation, separate limits are applied to specific categories of income, including financial services income and passive income. Income falling in the financial services income category includes certain types of income received or accrued by a person predominately engaged in the active conduct of banking, insurance or a similar business, including passive income. Passive income included in the financial services income category is determined before the exception that treats passive income as subject to another separate limitation category if the passive income falls within that category. Prior to the Taxpayer Relief Act of 1997, it was unclear whether financial services income included passive income before the high-taxed income exception was applied.

Foreign tax credit limitation for financial services income clarified.— The separate foreign tax credit limitation category for financial services income is clarified to include passive income, as determined before the high-taxed income exception for passive income is applied. High-taxed income is, therefore, *not* excluded from the separate foreign tax credit limitation for financial services income.

Effective date. The provision is effective on August 5, 1997.

Act Sec. 1163(b), amending Code Sec. 904(d)(2)(C)(i)(II); Act Sec. 1163(c). Law at ¶ 5287. Committee Report at ¶ 11,850.

Dividends from 10/50 Companies

¶ 915

Background

Prior to the Taxpayer Relief Act of 1997, a separate foreign tax credit limitation applied to dividends received from *each* noncontrolled Code Sec. 902 corporation. A noncontrolled Code Sec. 902 corporation is a foreign corporation with respect to which a domestic corporation owns at least 10 percent of the voting stock of the corporation and the foreign corporation is between 10 and 50 percent U.S. owned (so-called "10/50 company").

Foreign tax credit limitations for dividends simplified.—The rules for applying the separate foreign tax credit limitation to dividends received from noncontrolled Code Sec. 902 corporations (so-called "10/50 companies") are simplified under the Act. Separate rules are applied, depending upon whether the

dividends are paid from pre-2003 or post-2002 earnings and profits. Earnings and profits are determined under Code Sec. 316 rules.

Pre-2003 earnings. In the case of dividends from a noncontrolled Code Sec. 902 corporation that are paid from earnings and profits accumulated in tax years beginning before January 1, 2003, the dividends are treated as coming from one noncontrolled Code Sec. 902 corporation. Accordingly, the limitation is applied to *all* dividends paid from noncontrolled Code Sec. 902 corporations, rather than to dividends paid from *each* noncontrolled Code Sec. 902 corporation. However, if the corporation is also a passive foreign investment company, as defined under Code Sec. 1297, the foreign tax credit limitation is applied to dividends paid from *each* noncontrolled Code Sec. 902 corporation.

Post-2002 earnings. Look-through rules apply to dividends from a noncontrolled Code Sec. 902 corporation that are paid from earnings and profits accumulated in tax years beginning after December 31, 2002. Under the rules, a dividend from a noncontrolled Code Sec. 902 corporation is treated as income in a foreign tax credit limitation category in proportion to the ratio of (1) earnings and profits attributable to income in the foreign tax credit limitation category to (2) total earnings and profits.

Earnings and profits for pre-acquisition periods. The IRS is authorized to issue regulations regarding the treatment of distributions out of earnings and profits for periods before the taxpayer acquired the stock. According to the House Committee Report, if the regulations treat distributions from a foreign corporation out of earnings and profits for the pre-acquisition period as subject to the separate foreign tax credit limitation, it is expected that the regulations will allow the taxpayer to elect to apply the separate foreign tax credit limitation, rather than the limitation for dividends from each noncontrolled Code Sec. 902 corporation, to distributions out of post-acquisition earnings and profits.

Effective date. The provision applies to tax years beginning after December 31, 2002.

Act Sec. 1105(a)(1), amending Code Sec. 904(d)(1)(E); Act Sec. 1105(a)(2), adding Code Sec. 904(d)(2)(E)(iv); Act Sec. 1105(a)(3), amending Code Sec. 904(d)(2)(C)(iii)(II) and (D); Act Sec. 1105(b), redesignating Code Sec. 904(d)(4) and (5), as Code Sec. 904(d)(5) and (6), respectively, and adding new Code Sec. 904(d)(4); Act Sec. 1105(c). Law at ¶ 5287. Committee Report at ¶ 11,635.

Holding Period with Respect to Dividends

¶ 917

Background

A U.S. person who receives a foreign source dividend is generally entitled to claim a foreign tax credit for the foreign taxes paid or accrued with respect to the dividend. An indirect foreign tax credit can also be claimed for taxes deemed paid by lower-tier corporations under Code Sec. 902 and Code Sec. 960. Under Code Sec. 853, the shareholders of a regulated investment company (RIC) may claim the foreign tax credit for foreign income taxes paid by the RIC if the RIC elects to treat its foreign taxes as paid by the shareholders. Before the Taxpayer Relief Act of 1997, there was no stock holding period requirement for claiming the foreign tax credit. Absent a holding period, it was possible for persons to engage in tax-motivated transactions designed to transfer foreign tax credits from those who

Background

could not benefit from the credit (i.e., tax-exempt organization) to those who could. These tax-motivated transactions might involve the short-term transfer of ownership of dividend-paying shares or the use of derivatives.

Holding period requirement.—A holding period requirement is imposed for purposes of crediting foreign taxes associated with foreign-source dividends. In general, a taxpayer is not entitled to a tax credit for foreign withholding taxes paid with respect to a dividend if a 16-day holding period for the dividend-paying stock (or a 46-day holding period for certain dividends on preferred stock) is not satisfied. The holding period generally does not include any period during which the taxpayer is protected from risk of loss.

Regardless of the holding period, the taxpayer is not entitled to a tax credit for foreign withholding taxes on a dividend to the extent that the dividend recipient is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

The term "withholding tax" includes any tax determined on a gross basis and excludes taxes that are in the nature of a prepayment of tax imposed upon a net basis.

Taxes deemed paid. The holding period requirement also applies to foreign taxes treated as paid by the taxpayer indirectly under the Code Sec. 853 regulated investment company (RIC) rules or the Code Sec. 902 and Code Sec. 960 indirect tax credit rules. The foreign tax credit is disallowed if the stock in the corporation that must be owned to obtain the credit does not meet the holding period requirement or the corporation holding the stock is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

Calculating the holding period. The 16-day holding period requirement must be met within the 30-day period beginning 15 days before the ex-dividend date. If the stock is held for 15 days or less during the 30-day period, the foreign tax credit for the withholding tax on the dividend is disallowed.

For purposes of determining the period that the taxpayer has held the stock, certain holding period rules that apply for purposes of the dividends received deduction under Code Sec. 246(c)(3) and Code Sec. 246(c)(4) apply.

Under Code Sec. 246(c)(3), the holding period is determined by (1) taking into account the day of disposition, but not the day of acquisition, (2) excluding any day that is more than 45 days (90 days in the case of preferred dividends) from the ex-dividend date, and (3) not applying Code Sec. 1223(4), which adds the holding period of securities or stock on which loss was disallowed under the wash sales provisions of Code Sec. 1091 to the holding period of the stock or securities.

Under Code Sec. 246(c)(4), the holding period is reduced for periods when the risk of loss is diminished. Under Code Sec. 246(c)(4), risk of loss is diminished if the taxpayer (1) has an option to sell, is under a contractual obligation to sell, or has made, but not closed, a short sale of substantially similar or related property; (2) is the grantor of an option to buy substantially identical stock or securities; or (3) has, under regulations, another position or positions that substantially diminish the taxpayer's risk of loss from holding the stock. For example, according to the Senate Committee Report, a taxpayer will not be considered at risk during the time he

holds both foreign common stock and an equity swap that entitles him to payments equal to losses on the stock.

If the holding period is reduced under the Code Sec. 246(c)(4), there is a special rule for purposes of the indirect credit under Code Sec. 902 and Code Sec. 960. Under the rule, an exception from the risk reduction rule exists for *bona fide* contracts to sell stock. In such a case, the determination of whether the holding period is met is made on the date the contract for the bona fide sale of stock is entered into.

Exception for securities dealers. An exception from the holding period requirements exists for qualified taxes paid in connection with a security by securities dealers. For the exception to apply, the security must be held in the active conduct in a foreign country of a person's security business. The person must be (1) a registered securities broker or dealer under 15(a) of the Securities Exchange Act of 1934; (2) registered as a Government securities broker or dealer under 15C(a) of the Securities and Exchange Act of 1934; or (3) licensed or authorized to conduct securities activities in a foreign country and subject to bona fide regulations by the foreign country's securities regulating authority. "Qualified taxes" are taxes paid to a foreign country, other than the country in which the security dealer conducts business. The country where the security dealer conducts business must impose the tax on the dividend on a net basis and allow a credit against the net basis tax for the full amount of tax paid. The IRS is authorized to issue regulations that prevent the abuse of the exception or that would treat other taxes as qualified taxes not subject to the holding period.

Additional consequences of not meeting the holding period requirements. Taxpayers that fail to meet the holding period requirements are allowed a deduction equal to the foreign tax credits disallowed. Additionally, the Code Sec. 78 gross-up rules do not apply. Under Code Sec. 78, a domestic corporate shareholder is required to include foreign taxes deemed paid in gross income as a dividend.

RIC notice requirements. A regulated investment company (RIC) must notify its shareholders of the amount of foreign taxes that would be disallowed for failure to meet the holding period requirements. The notice requirement applies regardless of whether the RIC elects to have its foreign taxes treated as paid by the shareholder.

Effective date. The provision applies to dividends paid or accrued more than 30 days after August 5, 1997 (September 5, 1997).

Act Sec. 1053(a), redesignating Code Sec. 901(k) as Code Sec. 901(l) and adding new Code Sec. 901(k); Act Sec. 1053(b), amending Code Sec. 853(c); Act Sec. 1053(c). Law at ¶ 5265 and 5283. Committee Report at ¶ 11,375.

Deemed Paid Amount

¶ 919

Background

For purposes of determining a foreign corporation's deemed paid foreign tax credit under Code Sec. 902, a foreign corporation's post-1986 foreign income taxes must be determined. Prior to the Taxpayer Relief Act of 1997, post-1986 foreign income taxes were defined as foreign income taxes paid, accrued, or deemed paid, with respect to prior tax years beginning after 1986, to the extent that the taxes

Background

were not *deemed paid* with respect to dividends distributed by a foreign corporation in prior tax years.

Post-1986 foreign income taxes clarified.—For purposes of determining a foreign corporation's deemed paid foreign tax credit under Code Sec. 902, post-1986 foreign income taxes are clarified to include foreign income taxes paid, accrued, or deemed paid, with respect to prior tax years beginning after 1986, to the extent that the taxes were not *attributable* to dividends distributed by a foreign corporation in prior tax years.

> **Example.** Corporation D, a domestic shareholder, is entitled to a deemed-paid credit as a result of a dividend it receives from foreign Corporation A in 1997. In 1997, A also distributes a dividend to Jim Smith, a U.S. citizen. For 1998, the post-1986 foreign tax pool must be reduced by the total amount of taxes that are attributable to the distributions made to D and Jim Smith.

PRACTICAL ANALYSIS. Paul Bodner, Esq., Great Neck, N.Y., notes that, although labeled a clarification, the Committee Reports indicate that no inference is intended regarding present law. Although this treatment may be fair, consistency would require the IRS to accept the Tax Court decision in *Vulcan Materials Co. v. Commissioner*, 96 TC 410 (1991), *aff'd* 959 F2d 973 (11th Cir. 1992), *nonacq* 1995-1 CB 1. In *Vulcan*, only the U.S. shareholder's portion of the income was subject to tax, the local shareholder's portion was exempt. The Commissioner mechanically contended that foreign taxes could not be traced and therefore the effective foreign tax rate was one-half the economic cost to the U.S. shareholder. This Code amendment is designed to deny the taxpayer position that the pool of foreign income taxes should not be reduced by the foreign income taxes attributable to dividends received by non-U.S. shareholders. If equity prevails, the Commissioner should win the issue affected by this *clarification* and lose the *Vulcan* issue.

Effective date. The amendment is effective on August 5, 1997.

Act Sec. 1163(a), amending Code Sec. 902(c)(2)(B); Act Sec. 1163(c). Law at ¶ 5285. Committee Report at ¶ 11,845.

Period of Limitations

¶ 922

Background

In the case of an overpayment attributable to foreign tax credits, the limitations period for filing a claim for refund or credit is 10 years from the filing date for the return for the tax year with respect to which the claim is made. With respect to a claim that results from a foreign tax credit carryforward, it was unclear under prior law whether the period of limitations was determined by reference to the date for filing the return for the year *in which* the foreign taxes were paid or accrued

Background

(Rev. Rul. 84-125, 1984-2 CB 125) or the year *to which* the foreign tax credits were carried (*Ampex Corp.*, FedCl, 80-1 USTC ¶ 9358, 620 F2d 853).

Limitations period clarified.—The 10-year limitations period for filing a claim for credit or refund attributable to a foreign tax credit carryforward is clarified. The limitations period is determined by reference to the date for filing the return for the year in which the foreign taxes were paid or accrued, rather than the year to which the foreign tax credits are carried. The provision reverses the decision in *Ampex Corp.*, FedCl, 80-1 USTC ¶ 9358, 620 F2d 853, which held that the limitations period was determined by reference to the year to which the foreign tax credits were carried.

Effective date. The provision applies to taxes paid or accrued in tax years beginning after August 5, 1997.

Act Sec. 1056(a), amending Code Sec. 6511(d)(3)(A); Act Sec. 1056(b). Law at ¶ 5681. Committee Report at ¶ 11,390.

Interest on Underpayments

¶ 924

Background

Creditable foreign taxes that exceed the foreign tax credit limitation may be carried back two years and forward five years. Under the general restricted interest rule of Code Sec. 6601(d), when a deficiency is reduced by a loss or credit carryback, interest must be paid on the deficiency until the filing date of the loss- or credit-generating year. Restricted interest principles are also applied in the case of overpayments created by foreign tax credit carrybacks under Code Sec. 6611(g). Under Code Sec. 6611(g), a taxpayer is not entitled to interest on an overpayment during the restricted interest period ending with the filing date of the carryback-generating year. Prior to the Taxpayer Relief Act of 1997, a similar statutory provision did not exist for underpayments reduced or satisfied by foreign tax credit carrybacks. Application of the restricted interest rules in the case of such an underpayment was unclear as a result of the decision in *Fluor Corp.*, FedCl, 96-1 USTC ¶ 50,300. In *Fluor*, the court did not apply the restricted interest rule to an underpayment of tax satisfied by a foreign tax carryback.

Interest on underpayments not reduced by foreign tax credit carrybacks.—The restricted interest rule, which applied by statute only in the case of an overpayment of tax created by a foreign tax credit carryback, is extended to an underpayment of tax that is reduced or eliminated by a foreign tax credit carryback. A deficiency is not considered eliminated until the filing date of the tax year in which the foreign tax credit carryback arose. The application of the restricted interest rule is also clarified in the case of an underpayment that is reduced, or an overpayment that is created, by a foreign tax credit carryback, when the carryback is triggered by either a net operating or net capital loss carryback.

The provision applies the restricted interest rule consistently for both underpayments and overpayments affected by federal tax credit carrybacks. The provision reverses *Fluor Corp.*, FedCl, 96-1 USTC ¶ 50,300, which did not apply the

restricted interest rule to an underpayment of tax that was satisfied by a foreign tax credit carryback.

Underpayments. A taxpayer must pay interest on the deficiency until the filing date of the credit-generating year (i.e., tax year in which the foreign taxes were paid or accrued). When the foreign tax credit carryback is triggered by either a net operating or net capital loss carryback, the taxpayer must pay interest on the deficiency until the filing date of the loss-generating year (i.e., tax year in which the loss arose).

> **Example.** Joe Smith, who is a calendar-year taxpayer, has an underpayment of tax of $800 for 1996. Interest on the underpayment runs from April 15, 1997, the last day prescribed for payment of the 1996 tax. In 1998, Joe pays foreign taxes to Country X, which exceed the foreign tax credit limitation by $200. The excess credits of $200 are carried back to 1996 and reduce the $800 deficiency. Interest must be paid on the $800 deficiency from April 15, 1997 until April 15, 1998. After April 15, 1998, interest is paid on the $600 deficiency.

Overpayments. When the foreign tax credit carryback is triggered by either a net operating or net capital loss carryback, the taxpayer is not entitled to interest on the overpayment of tax that is created until the filing date of the loss-generating year (i.e., the tax year in which the loss arose).

Effective date. The provision applies to foreign tax credit carrybacks arising in tax years beginning after August 5, 1997.

Act Sec. 1055(a), redesignating Code Sec. 6601(d)(2) and (3) as Code Sec. 6601(d)(3) and (4), respectively, and adding new Code Sec. 6601(d)(2); Act Sec. 1055(b)(1), redesignating Code Sec. 6611(f)(2) and (3) as Code Sec. 6611(f)(3) and (4), respectively, and adding new Code Sec. 6601(f)(2); Act Sec. 1055(b)(2), amending Code Sec. 6611(f)(4), as redesignated, and striking Code Sec. 6611(g) and redesignating Code Sec. 6611(h) and (i) as 6611(g) and (h), respectively; Act Sec. 1055(c). Law at ¶ 5685 and 5687. Committee Report at ¶ 11,385.

EXPATRIATION TAX PROVISIONS

Gain Recognition on Certain Exchanges

¶ 926

Background

Code Sec. 877 provides for an expatriation tax that applies to U.S. citizens and long-term residents who terminate U.S. citizenship or residency and expatriate in order to avoid U.S. income tax. Generally, for 10 years following the date of the loss of U.S. citizenship or residency, such former U.S. citizens and former long-term U.S. residents are taxed on their gross income under the graduated rate structure applicable to citizens and residents, except that their gross income includes only U.S.-source income and income effectively connected with a U.S. trade or business. Under the expatriation provisions, U.S.-source income includes certain additional items listed below.

Tax avoidance purpose. For the expatriation provisions to apply, the expatriate must have had tax avoidance as one of his principal purposes for relinquishing citizenship or residency status. A presumption of a tax avoidance purpose applies to high income and high net worth individuals.

Background

Source rules, etc. Under the expatriation provisions, a series of rules concerning source of income, gain recognition and other issues are applicable during the 10-year period in order to prevent tax avoidance:

First, the following items of income or gain are deemed to be U.S.-source: gains on the sale of property located in the United States, gains on sales of stock issued by domestic corporations or debt obligations of U.S. issuers, and income or gain derived from certain sales of controlled foreign corporation (CFC) stock.

Second, exchanges of property following the loss of citizenship or residency require gain recognition, unless a gain recognition agreement was entered into. Regulatory authority is given to the Treasury to extend the 10-year expatriation tax period to a total of 15 years, which includes the five-year period prior to the loss of residency or citizenship.

Third, for purposes of determining whether the expatriation tax will apply to gain on the sale or exchange of property, the running of the 10-year period is suspended for any period during which the expatriate's risk of loss with respect to the property is substantially diminished.

Fourth, income or gain received or accrued by a CFC on property that had been contributed to the CFC by the former citizen or resident generally is treated as received or accrued directly by the expatriate and not by the CFC.

After amendment by the Act, these rules remain generally the same, but are subject to certain technical corrections, which are outlined below and in ¶ 928 and 929.

Gain recognition period clarified.—Under the expatriation provisions, the expatriate must recognize gain on property transactions that would otherwise receive nonrecognition treatment if the property is transferred during the 10-year period following the loss of U.S. citizenship or residency.and income from either the property transferred or the property received in the exchange is U.S. source. Also, Treasury is given regulatory authority to apply this rule during the five-year period prior to the loss of residency or citizenship.

In a technical correction, the Act clarifies that, for purposes of the gain recognition rule,.the 10-year period begins on the date of the loss of U.S. citizenship or residency status. Also, for exchanges occurring during the five-year period before the loss of U.S. citizenship or residency status, any gain required to be recognized under regulations must be recognized immediately after the date of the loss of citizenship or residency.

Effective date. These amendments apply to individuals who lose U.S. citizenship and to long-term residents who terminate U.S. residency on or after February 6, 1995. The amendments also apply to individuals who performed an act of expatriation prior to February 6, 1995, but after February 5, 1994, and who failed to furnish the State Department with a signed statement relinquishing citizenship by February 6, 1995.

Act Sec. 1602(g)(1), amending Code Sec. 877(d)(2)(B); Act Sec. 1602(g)(2), amending Code Sec. 877(d)(2)(D); Act Sec. 1602(i). Law at ¶ 5279. Committee Report at ¶ 13,875 and 13,880.

Suspension of 10-Year Period

¶ 928

Suspension of 10-year period for diminution of risk of loss clarified.—Under the expatriation provisions described more fully at ¶ 926, above, gains recognized within the 10-year period following loss of citizenship or residency are taken into account for expatriation tax purposes if the gains are U.S.-source or effectively connected with a U.S. trade or business. Gains on the sale of property located in the United States, gains on the sale of stock issued by domestic corporations or debt obligations of U.S. issuers, and income or gain derived from certain sales of controlled foreign corporation (CFC) stock are deemed to be U.S.-source.

With respect to gains on the sale or exchange of property, the 10-year period is suspended for any period during which the expatriate's risk of loss with respect to the property is substantially diminished through options or similar risk-shifting transactions. The Act clarifies that the 10-year period begins on the date that the expatriate loses citizenship or long-term resident status.

Effective date. These amendments apply to individuals who lose U.S. citizenship and to long-term residents who terminate U.S. residency on or after February 6, 1995. The amendments also apply to individuals who performed an act of expatriation prior to February 6, 1995, but after February 5, 1994, and who failed to furnish the State Department with a signed statement relinquishing citizenship by February 6, 1995.

Act Sec. 1602(g)(3), amending Code Sec. 877(d)(3); Act Sec. 1602(i). Law at ¶ 5279. Committee Report at ¶ 13,885.

Contributions to Controlled Foreign Corporations

¶ 929

Treatment of property contributed to certain foreign corporations (CFCs) clarified.—Under the expatriation provisions described more fully at ¶ 926, above, income or gain received or accrued by a CFC on property contributed to the CFC by an expatriate is treated as received or accrued directly by the expatriate and not by the CFC, provided that income derived from the property, if any, was U.S.-source.

The Act clarifies that the rule concerning contributions to a CFC applies to contributions made during the 10-year period that begins on the date that the expatriate loses citizenship or long-term resident status. It is also clarified that, in applying the rule, the determination of whether the property generated U.S.-source income is made by looking at the source of income immediately before the contribution.

Effective date. These amendments apply to individuals who lose U.S. citizenship and to long-term residents who terminate U.S. residency on or after February 6, 1995. The amendments also apply to individuals who performed an act of expatriation prior to February 6, 1995, but after February 5, 1994, and who failed to furnish the State Department with a signed statement relinquishing citizenship by February 6, 1995.

Act Sec. 1602(g)(4), amending Code Sec. 877(d)(4)(A); Act Sec. 1602(i). Law at ¶ 5279. Committee Report at ¶ 13,890.

Foreign Estate Tax Credit

¶ 930

Background

Where a U.S. citizen or long-term resident relinquishes citizenship or residency with a principal purpose of tax avoidance, the expatriation provisions of Code Sec. 2107 apply if the individual dies within the 10-year period following loss of citizenship or residency. Under Code Sec. 2107, the expatriate's gross estate includes his pro rata share of any U.S.-situs property held through a controlled foreign corporation (CFC), provided that the expatriate's stock ownership in the CFC meets certain thresholds. A limited credit for foreign death taxes is available to offset the foreign tax paid, if any, on amounts included in the expatriate's U.S. gross estate as a result of his ownership of CFC stock.

After amendment by the Act, these rules remain generally the same, but the credit for foreign death taxes is clarified.

Foreign estate tax credit formula clarified.—The estate of a U.S. citizen or long-term resident who relinquishes citizenship or residency status with a tax avoidance purpose is subject to the expatriation provisions of Code Sec. 2107 if he or she dies during the 10-year period following loss of citizenship or residency status.

In general, such former U.S. citizens or residents are taxed in the same manner as other nonresident aliens. Accordingly, the gross estate is limited to U.S.-situs property. However, the expatriate's gross estate also includes his pro rata share of any U.S.-situs property held through a controlled foreign corporation (CFC) in which he or she owned at least 10 percent of the total voting shares and, together with related persons, owned at least 50 percent of the total CFC stock by vote or value.

The amount included in the expatriate's gross estate by reason of his ownership interest in a CFC may also be subject to foreign estate tax. For that reason, the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) added a credit for foreign death taxes. For the credit to apply, the foreign tax must be paid in respect of the value of CFC stock that is owned by the decedent and included in his gross estate solely as a result of the expatriation provisions. In addition, the credit for foreign death taxes is subject to certain limitations.

The Act clarifies the formula used in computing the foreign death tax credit limitation. As amended, the foreign death tax credit is limited to the lesser of:

(1) the amount of foreign taxes paid multiplied by the ratio of the value of property subjected to foreign tax and included in the decedent's U.S. gross estate by reason of his ownership of CFC stock over the total value of the decedent's gross estate that is subject to foreign death taxes; or

(2) the amount of U.S. estate tax attributable to property that is subject to payment of foreign tax and is includible in the decedent's U.S. estate solely by reason of the expatriation tax provisions.

Effective date. These amendments apply to individuals who lose U.S. citizenship and to long-term residents who terminate U.S. residency on or after February 6, 1995. The amendments also apply to individuals who performed an act of expatriation prior to February 6, 1995, but after February 5, 1994, and who failed

to furnish the State Department with a signed statement relinquishing citizenship by February 6, 1995.

Act Sec. 1602(g)(6), amending Code Sec. 2107(c)(2); Act Sec. 1602(i). Law at ¶ 5443. Committee Report at ¶ 13,895.

CONTROLLED FOREIGN CORPORATIONS

Gain on Stock Sales

¶ 932

Background

If an upper-tier controlled foreign corporation (CFC) sells stock of a lower-tier CFC, the gain is included in the income of U.S. 10-percent shareholders as subpart F income. Further, the U.S. shareholder's basis in the stock of the first-tier CFC is increased to account for the inclusion. Under prior law, the inclusion was not characterized for foreign tax credit limitation purposes by reference to the nature of the income of the lower-tier CFC. Instead, it was characterized as passive income.

For purposes of the foreign tax credit limitation applicable to so-called 10/50 companies, a CFC was not treated as a 10/50 company with respect to any distribution out of its earnings and profits, for periods during which it was a CFC and, except as provided by regulations, the recipient of the distribution was a U.S. 10-percent shareholder in such corporation.

Treatment of stock sale gain.—Gain recognized on the sale or exchange of stock in a foreign corporation by a controlled foreign corporation (CFC) is included in the CFC's gross income as a dividend to the same extent that it would have been included under Code Sec. 1248(a) if the CFC were a U.S. person. This provision does not affect the determination of whether the corporation whose stock is sold or exchanged is a CFC.

> **Example.** Corp. A is a U.S. corporation that owns 100% of the stock of Corp. B, a foreign corporation, which in turn owns 100% of the stock of Corp. C, another foreign corporation. Any gain to Corp. B on the sale or exchange of Corp. C's stock is treated as a dividend for purposes of subpart F income inclusions to the U.S. shareholder, to the extent of Corp. C's earnings and profits attributable to periods in which Corp. B owned Corp. C's stock while Corp. C was a CFC with respect to the U.S. shareholder.

Same country exception. The same country exception, as contained in Code Sec. 954(c)(3)(A)(i), does not apply to any amount treated as a dividend under the new provision. Thus, gain on the disposition of stock in a related corporation created or organized under the laws of (and having a substantial part of its assets in a trade or business in) the same foreign country as the gain recipient (even if recharacterized as a dividend under this provision) is not excluded from personal holding company income under the same country exception that applies to actual dividends.

Deemed sales. A CFC is treated as having sold or exchanged any stock if that CFC is treated as having gain from the sale or exchange of the stock under the income tax provisions of the Code. Therefore, if a CFC distributes stock in a foreign corporation to its shareholder, and the distribution results in the CFC recognizing

gain as if the stock were sold for its fair market value to the shareholder, then the CFC is treated as having sold or exchanged the stock.

FTC U.S. shareholder rule repealed. Code Sec. 904(d)(2)(E)(i) is modified to provide that for foreign tax credit limitation purposes, a CFC is no longer treated as a 10/50 company with respect to any distribution out of its earnings and profits for periods during which it was a CFC, whether or not the recipient of the distribution was a U.S. 10-percent shareholder of the corporation when the earnings and profits giving rise to the distribution were generated.

Effective date. The gain inclusion provision applies to gain recognized on transactions occurring after August 5, 1997, while the repeal of the 10-percent shareholder requirement for foreign tax credit limitation purposes is effective for distributions after August 5, 1997.

Act Sec. 1111(a), adding Code Sec. 964(e); Act Sec. 1111(b), amending Code Sec. 904(d)(2)(E)(i); Act Sec. 1111(c). Law at ¶ 5287 and 5307. Committee Report at ¶ 11,655.

Indirect Foreign Tax Credit

¶ 934

Background

A U.S. corporation that owns at least 10 percent of the voting stock of a foreign corporation is treated as if it had paid a share of the foreign income taxes paid by the foreign corporation in the year in which the foreign corporation's earnings and profits become subject to U.S. tax as dividend income of the U.S. shareholder. Under prior law, a U.S. corporation was deemed to have paid taxes paid by a second- or third-tier foreign corporation under certain circumstances.

Extension to lower tiers.—The indirect foreign tax credit has been extended to taxes paid or accrued by fourth-, fifth- and sixth-tier corporations. To qualify, the corporation must be a controlled foreign corporation (CFC), the U.S. corporation claiming the tax credit must be a U.S. shareholder (as defined in Code Sec. 951(b)), and the product of the percentage ownership of voting stock at each level from the U.S. corporation down must equal at least five percent. The indirect foreign tax credit is extended to lower tiers only with respect to taxes paid or incurred in tax years during which the payor is a CFC.

Planning Note. The sophisticated corporate restructuring that was necessitated by the third-tier limits is no longer required. The extension of the indirect foreign tax credit down to the sixth level eliminates the burden on the parent corporation to ensure that lower-level foreign subsidiaries with large creditable tax amounts were situated at a proper higher-tier level. However, foreign taxes paid below the sixth tier of foreign corporations remain ineligible for the tax credit.

Effective date. This provision applies to taxes of foreign corporations for tax years of these corporations beginning after August 5, 1997. No liquidation, reorganization or similar transaction in a tax year beginning after August 5, 1997 will have the effect of permitting taxes to be taken into account that could not have been taken into account under Code Sec. 902 but for the transaction.

Act Sec. 1113(a)(1), amending Code Sec. 902(b); Act Sec. 1113(a)(2)(A), amending Code Sec. 902(c)(3)(B); Act Sec. 1113(a)(2)(B), amending Code Sec. 902(c)(4)(B); Act Sec. 1113(a)(2)(C), amending Code

Sec. 902(c)(3); Act Sec. 1113(a)(2)(D), amending Code Sec. 902(c)(3); Act Sec. 1113(b), amending Code Sec. 960(a)(1); Act Sec. 1113(c). Law at ¶ 5285 and 5303. Committee Report at ¶ 11,665.

Foreign Personal Holding Company Income

¶ 936

Background

Ten-percent U.S. shareholders of controlled foreign corporations (CFCs) are subject to current U.S. tax on certain income earned by the CFCs under the subpart F rules. One category of income subject to current tax under the subpart F rules is foreign personal holding company income. Prior to the Taxpayer Relief Act of 1997, for subpart F purposes, foreign personal holding company income generally included interest, dividends, and annuities; some rents and royalties; net commodities gains; net foreign currency gains; net gains from the sale and exchange of certain property; and income that is the equivalent of interest. Also under prior law, only gains and losses from the sale and exchange of property realized by regular dealers in property were excepted from the definition of foreign personal holding company income. The regular dealer exception also applied to gains and losses arising from bona fide hedging transactions entered into in the course of being a regular dealer in property.

Foreign personal holding company income defined.—For purposes of the subpart F rules that apply to 10-percent shareholders of controlled foreign corporations (CFCs), the definition of foreign personal holding company income has been expanded to include income from notional principal contracts and payments in lieu of dividends. The exception from foreign personal holding company income that applies to regular dealers in property is also expanded.

The House Committee Report states that the expanded rules apply for purposes of determining a foreign corporation's status as a passive foreign investment company.

Notional principal contracts. Net income from a notional principal contract is included in foreign personal holding company income. However, income, gain, deduction or loss from a notional principal contract that is entered into to hedge income in another category of foreign personal holding company income is income in that category. The Conference Committee clarifies that income from a notional principal contract entered into to hedge inventory property can be excluded from foreign personal holding company income under the exclusion that applies to gains and losses from transactions in inventory property.

Payments in lieu of dividends. Payments in lieu of dividends under an equity securities agreement, as required under Code Sec. 1058, are included in foreign personal holding company income.

Dealer exception. The exception from foreign personal holding company income that applies to gain or loss from the sale or exchange of property by regular dealers under Code Sec. 954(c)(1)(B) also applies to dealers in financial instruments. Income, gain, deduction, or loss from any transaction (including a hedging transaction) of a regular dealer in property, forward contracts, option contracts and similar financial instruments is not taken into account when computing foreign personal holding company income. A "similar financial instrument" includes a notional principal contract and all instruments referenced to commodities.

Effective date. The provisions apply to tax years beginning after August 5, 1997.

Act Sec. 1051(a)(1), adding Code Sec. 954(c)(1)(F) and (G); Act Sec. 1051(a)(2), amending Code Sec. 954(c)(1)(B); Act Sec. 1051(b), adding Code Sec. 954(c)(2)(C); Act Sec. 1051(c). Law at ¶ 5299. Committee Report at ¶ 11,365.

Miscellaneous Subpart F Modifications

¶ 937

Background

Under prior law, no provision was allowed for an adjustment to the basis of an upper-tier CFC's stock in a lower-tier CFC if subpart F income of a lower-tier CFC was included in the gross income of a U.S. 10-percent shareholder. Also, although the subpart F income earned by a foreign corporation during its tax year is taxed to the U.S. 10-percent shareholders of the corporation on the last day of that year, in which the corporation is a CFC, in the case of a U.S. 10-percent shareholder who acquired stock in a CFC during the year, the inclusions were reduced by all or a portion of the amount of dividends paid in that year by the foreign corporation to any person other than the acquiror with respect to that stock. Further, even though subpart F income generally does not include income earned from sources within the United States if the income is effectively connected with the conduct of a U.S. trade or business by the CFC, this general rule did not apply if the income was exempt from, or subject to a reduced rate of, U.S. tax pursuant to a provision of a U.S. treaty.

Basis adjustment.—The subpart F income of a 10-percent U.S. shareholder from gain on the disposition of a lower-tier controlled foreign corporation (CFC) is to be reduced, under regulations to be provided by the IRS, by income inclusions of earnings that were not subsequently distributed by the lower-tier CFC. This is similar to the adjustment made to the basis of stock in a first-tier CFC for income inclusions.

> **Example.** Lynne Smith, a U.S. person, owns all of the stock of a first-tier CFC, which is the sole shareholder of a second-tier CFC. In 1998, the second-tier CFC earns $1,000 of subpart F income which is included in Smith's income. In the following year, the first-tier CFC disposes of the second-tier CFC's stock and recognizes a $5,000 gain. Under the basis adjustment change, the IRS is authorized to issue regulations to ensure that Smith's subpart F inclusion of this gain is reduced by the earlier $1,000 amount previously included in her income.

Inclusion in year of acquisition. If a U.S. 10-percent shareholder acquires the stock of a CFC from another U.S. 10-percent shareholder during a tax year of the CFC in which it earns subpart F income, the acquiror's subpart F income inclusion for that year is reduced by a portion of the amount of the dividend deemed to be received by the transferor under Code Sec. 1248. The portion by which the inclusion is reduced (as is the case if a dividend was paid to the previous owner of the stock) does not exceed the lesser of the amount of dividends with respect to the stock deemed received by other persons during the year or the amount determined by multiplying the subpart F income for the year by the proportion of the year during which the acquiring shareholder did not own the stock.

U.S. income earned by CFC. An exemption or reduction by treaty of the branch profits tax that would be imposed under Code Sec. 884 on a CFC does not affect the general statutory exemption from subpart F income that is granted for U.S.-source effectively connected income. Notwithstanding the treaty's effect on the branch tax, the income is not treated as subpart F income so long as it is not exempt from U.S. taxation (or subject to a reduced rate of tax) under any other treaty provision.

Effective date. The provision that provides for regulatory adjustments to U.S. shareholder inclusions (i.e., "basis adjustment", above) is effective for determining inclusions for tax years of U.S. shareholders beginning after December 31, 1997. Thus, the Act permits regulatory adjustments to an inclusion occurring after the effective date to account for income that was previously taxed under the subpart F provisions either prior to or subsequent to the effective date. The provision that permits dispositions of stock to be taken into consideration in determining a U.S. shareholder's subpart F inclusion for a tax year is effective with respect to dispositions occurring after August 5, 1997. The provision concerning the effect of treaty exemptions from, or reductions of, the branch profits tax on the determination of subpart F income is effective for tax years beginning after December 31, 1986.

Act Sec. 1112(a)(1), amending Code Sec. 951(a)(2); Act Sec. 1112(b)(1), adding Code Sec. 961(c); Act Sec. 1112(c)(1), amending Code Sec. 952(b); Act Sec. 1112(a)(2), Act Sec. 1112(b)(2), Act Sec. 1112(c)(2). Law at ¶ 5295, 5297, and 5305. Committee Report at ¶ 11,660.

Investment of Earnings in U.S. Property

¶ 938

Background

In general, the earnings of a controlled foreign corporation (CFC) that are invested in U.S. property are taxed on a current basis to the CFC's 10-percent U.S. shareholders. Specifically, a U.S. shareholder must include in gross income the lesser of the following:

(1) the shareholder's pro rata share of the CFC's investment in U.S. property less his share of the CFC's investment in U.S. property taxed to the shareholder in a prior tax year, or

(2) the shareholder's pro rata share of the CFC's undistributed earnings.

For purposes of the second amount, prior law defined earnings to include both current earnings and profits (not including a deficit) and accumulated earnings and profits, leaving the possible argument that current year earnings should be counted twice.

Definition of earnings invested in U.S. property clarified.—A technical correction clarifies the meaning of the term "applicable earnings," as used in measuring the income inclusion for a 10-percent U.S. shareholder in a controlled foreign corporation (CFC) resulting from his pro rata share of the CFC's investment in U.S. property. As clarified, the term refers to the sum of the CFC's current year earnings and accumulated earnings to the extent accumulated in prior tax years. Thus, the possible interpretation under prior law that current year earnings should be taken into account twice is eliminated.

Effective date. The correction applies to tax years of foreign corporations beginning after December 31, 1996, and to tax years of U.S. shareholders with or within which such tax years of foreign corporations end.

Act Sec. 1601(e), amending Code Sec. 956(b)(1)(A). Law at ¶ 5301. Committee Report at ¶ 13,645.

Securities and Commodities Dealers

¶ 940

Background

When computing a U.S. tax liability, the U.S. 10-percent shareholders of a controlled foreign corporation (CFC) are required to currently include in income certain earnings of the CFC under the rules of subpart F (Code Secs. 951-964), whether or not such earnings are distributed currently to the shareholders. The U.S. 10-percent shareholders of a CFC are subject to current U.S. tax on their shares of certain income earned by the CFC (referred to as "subpart F income"). The U.S. 10-percent shareholders also are subject to current U.S. tax on their shares of the CFC's earnings to the extent invested by the CFC in certain U.S. property.

A U.S. 10-percent shareholder's current income inclusion with respect to a CFC's investment in U.S. property for a taxable year is based on the CFC's average investment in U.S. property for such year. For this purpose, the U.S. property held by the CFC must be measured as of the close of each quarter in the taxable year. U.S. property generally is defined to include tangible property located in the United States, stock of a U.S. corporation, obligations of a U.S. person, and the right to use certain intellectual property in the United States. Exceptions are provided for, among other things, obligations of the United States, U.S. bank deposits, certain trade or business obligations, and stock or debts of certain unrelated U.S. corporations.

Under prior law, no exception to the definition of U.S. property was provided for deposits of collateral or margin made or received in the ordinary course of business of a securities or commodities dealer or for repurchase agreements entered into in the ordinary course of business of a securities or commodities dealer.

U.S. property excludes certain assets of securities and commodities dealers.—The U.S. 10-percent shareholders of a controlled foreign corporation (CFC) are subject to current U.S. tax on their shares of the CFC's earnings to the extent invested by the CFC in certain U.S. property. Two additional exceptions from the definition of U.S. property for purposes of the subpart F rules have been provided under the Act. Both exceptions relate to "ordinary-course-of-business" transactions entered into by securities or commodities dealers. The Conference Committee Report clarifies that the addition of the exceptions is not intended to create any inference regarding the treatment of an obligation of a U.S. person to return stock that is borrowed pursuant to a securities loan.

Dealer deposits and repurchase agreements. U.S. property does not include deposits of cash or securities made or received by a securities or commodities dealer on commercial terms in the ordinary course of business as a dealer in securities or in commodities. However, the deposits must be made or received as collateral or margin for certain transactions. The approved transactions include a securities loan, notional principal contract, options contract, forward contract, futures con-

tract, or any other financial transaction in which the IRS determines that it is customary to post collateral or margin.

Also excluded from the definition of U.S. property are certain repurchase agreement transactions and reverse repurchase agreement transactions that occur in the ordinary course of a securities or commodities dealer's trade or business. The exception applies to an obligation of a U. S. person to the extent the principal amount of the obligation does not exceed the fair market value of readily marketable securities sold or purchased pursuant to a sale and repurchase agreement or otherwise posted or received as collateral for the obligation.

Dealer defined. For purposes of these rules, a dealer in securities is a taxpayer who regularly purchases securities from or sells securities to customers in the ordinary course of a trade or business or who regularly offers to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

Caution. There does not appear to be any exact definition of the term "dealer in commodities" for purposes of these rules. The Conference Committee Report indicated that the term means futures commission merchants and dealers in commodities within the meaning of the new definition that is added under the Act in Code Sec. 475(e). However, Code Sec. 475(e), as added by Section 1001(b) of the Act does not provide a definition of "dealer in commodities," even though it defines commodities for purposes of the mark-to-market election.

Effective date. The exclusion of certain property acquired by dealers in the ordinary course of business from the definition of U.S. property applies to tax years of foreign corporations beginning after December 31, 1997, and to tax years of U.S. shareholders with or within which such tax years of foreign corporations end.

Act Sec. 1173(a), adding Code Sec. 956(c)(2)(J) and (K); Act Sec. 1173(b). Law at ¶ 5301. Committee Report at ¶ 11,875.

Active Financing Income

¶ 942

→ Caution: Act Sec. 1175 was canceled by President Clinton on August 11, 1997, pursuant to his authority under the Line Item Veto Act (P.L. 104-130). As we go to press, this provision is deemed to be stricken from the Act. However, under the procedures set out in P.L. 104-130 (or as the result of a successful challenge of its constitutionality), this provision may be reinstated at a later date.←

Background

The subpart F rules of Code Sec. 951 through Code Sec. 964 historically have been aimed at requiring current inclusion by the U.S. shareholders of income of a controlled foreign corporation (CFC) that is either passive or easily movable. Prior to the enactment of the Tax Reform Act of 1986 (P.L. 99-514), exceptions from foreign personal holding company income were provided for income derived in the conduct of a banking, financing, or similar business or income derived from certain investments made by an insurance company. The repeal of these exceptions under the Tax Reform Act of 1986 resulted in the inappropriate extension of the subpart F provisions to income that is neither passive nor easily moveable.

Personal holding company exemption for active financing income.—A temporary exception from the definition of foreign personal holding company income for subpart F purposes applies to certain income that is (1) derived in the active conduct of a banking, financing or similar business by a controlled foreign corporation (CFC) predominantly engaged in the active conduct of such business or (2) received from an unrelated person and derived from particular investments made by a qualifying insurance company. The exceptions are applicable only for taxable years beginning in 1998.

Planning Note. This temporary exception should benefit a U.S. 10-percent shareholder of a CFC that earns such active financing income or qualifying insurance company income during its 1998 tax year. Without the temporary exception, the U.S. shareholder would be subject to current taxation on that income, regardless of whether the income is distributed to the U.S. shareholder.

Banking, finance or similar business income. Whether income is derived in the active conduct of a banking, financing, or similar business is generally determined under the principles applicable in determining financial services income for purposes of the separate foreign tax credit limitation. However, in the case of a corporation that is engaged in the active conduct of a banking or securities business, the income eligible for this exception is generally determined using the test for whether income is nonpassive under the passive foreign investment company rules under Code Sec. 1296(b) as in effect prior to the Act. According to the Conference Committee Report, the conferees intend that the income of a corporation engaged in the active conduct of a banking or securities business that is eligible for this exception is the income that is treated as nonpassive under Prop. Reg. § 1.1296-4 through Prop. Reg. § 1.1296-6.

A corporation is predominantly engaged in the active conduct of a banking, finance or similar business only if more than 70 percent of its gross income from the business is derived from transactions with unrelated persons located within the country under the laws of which the CFC is created or organized. Alternatively, the corporation must be engaged in the active conduct (see above) of a banking or securities business or the corporation must be a qualified bank affiliate or qualified securities affiliate.

Insurance income. A temporary exception from foreign personal holding company income is provided for certain investment income of a qualifying insurance company received from an unrelated person, as defined in Code Sec. 954(d)(3), and derived from investments of the company's assets in an amount equal to (1) one-third of its premiums, as defined in Code Sec. 832(b)(4), earned during the tax year on property, casualty, or health insurance contracts or (2) 10 percent of its reserves (or $10,000,000, if greater, in the case of a start-up company) on life insurance or annuity contracts. An exception is also provided for income received from an unrelated person from investments made by a qualifying insurance company of its reserves or 80 percent of its unearned premiums. Special rules under Code Sec. 904(h)(2)(B) and (C) limit the income taken into account under this temporary active financing exemption, and require look-through treatment, respectively.

Generally, the unearned premiums and reserves of a qualifying insurance company with respect to property, casualty or health insurance contracts are determined using the same methods and interest rates used as if the company were subject to tax under the rules for insurance companies in Subchapter L of the Code. The reserves of a qualifying insurance company with respect to life insurance or annuity contracts may be determined under one of three alternative methods:

(1) a "U.S. method" based on the rules of Subchapter L of the Code;

(2) a "foreign method" that uses a preliminary term foreign reserve method; or

(3) a "cash surrender value" method that uses the net surrender value of the contract. No reserve at any time can exceed the foreign annual statement reserve for the contract, reduced by any catastrophe or deficiency reserve.

A qualifying insurance company is generally defined as an entity that:

(1) is subject to regulation as an insurance company under the laws of its country of incorporation;

(2) realizes at least 50 percent of its net written premiums from the insurance or reinsurance of risks located within the country in which the entity is created or organized; and

(3) is engaged in the active conduct of an insurance business and would be subject to tax under Subchapter L of the Code if it were a domestic corporation.

Special rules apply to allocate income to a contract under Code Sec. 954(h)(2)(B).

Anti-abuse and other definitive rules. Items with respect to a transaction or series of transactions are disregarded if one of the principal purposes of the transactions is (1) to qualify income or gain for these exceptions or (2) to accelerate or defer any item in order to claim the benefit of these exceptions. Also, this active financing exception does not apply to investment income allocated to contracts that insure related party risks or risks located in a foreign country other than the country in which the qualifying insurance company is created or organized.

An exception from the definition of foreign base company income in Code Sec. 954 is provided in case of the 1998 tax year, for income exempt from the definition of foreign personal holding company income under these rules.

Effective date. The exemption for active financing income applies to the first full tax year of a foreign corporation beginning after December 31, 1997, and before January 1, 1999, and to tax years of U.S. shareholders with or within which such tax year of such foreign corporation ends.

Act Sec. 1175(a), adding Code Sec. 954(h); Act Sec. 1175(b), adding Code Sec. 954(e)(2)(C). Act Sec. 1175(c). Law at ¶ 5299. Committee Report at ¶ 11,885.

PASSIVE FOREIGN INVESTMENT COMPANIES

U.S. Shareholders of CFC That Is a PFIC

¶ 944

Background

Several anti-deferral regimes provide exceptions to the general rule that income of a foreign corporation is subject to U.S. income tax when paid to its U.S. shareholders.

One regime applies to controlled foreign corporations (CFCs). A foreign corporation is a CFC if more than 50 percent of the corporation's stock, measured by voting power or value, is owned by U.S. shareholders. A U.S. shareholder is U.S.

Background

person who owns, directly or indirectly, at least 10 percent of the corporation's stock, measured by voting power. U.S. shareholders are taxed currently on their pro rata shares of so-called subpart F income and their shares of CFC earnings invested in U.S. property.

Another anti-deferral regime applies to passive foreign investment companies (PFICs). A foreign corporation is a PFIC if 75 percent or more of its gross income consists of passive income or 50 percent of more of the average fair market value of its assets produce, or are held for the production of, passive income. How U.S. shareholders of PFICs are taxed depends on whether the PFIC is a "qualified electing fund." If it is, electing U.S. shareholders are taxed currently on their respective shares of the PFIC's earnings but may elect to defer payment of tax on income not currently received, subject to an interest charge. If a PFIC is nonqualified fund, U.S. shareholders are taxed on realized PFIC income and charged interest on deferred, unrealized income.

A foreign corporation can be both a CFC and a PFIC. In such a case, prior to the provision described below, the corporation's 10-percent shareholders would be subject to overlapping anti-deferral provisions.

Elimination of overlap for PFICs that are CFCs.—A corporation that otherwise would be a passive foreign investment company (PFIC) will not be treated as such with respect to certain shareholders if the corporation is also a controlled foreign corporation (CFC) under Code Sec. 957(a). This exception is available to shareholders who are 10-percent U.S. shareholders of the corporation under Code Sec. 951(b) for periods beginning after December 31, 1997. As a result, shareholders who are taxed currently on their pro rata shares of subpart F income of a CFC will not be subject to the PFIC income inclusion provisions with respect to the same stock. Conversely, the PFIC provisions will continue to apply to PFIC/CFC shareholders for any periods in which they are less than 10-percent shareholders.

PRACTICAL ANALYSIS. D. Kevin Dolan, of Weil, Gotshal & Manges' Washington, D.C. office (former IRS Associate Chief Counsel, Technical and International) notes that elimination of the application of PFIC rules to CFCs is a welcome simplification. U.S. shareholders of a CFC already are subject to a set of complex rules under subpart F. Application of PFIC rules to these shareholders created additional complexity which was not warranted by the anti-deferral objectives of either regime.

PRACTICAL ANALYSIS. Paul Bodner, Esq., Great Neck, N.Y., notes that the PFIC provisions were enacted to correct the foreign investment company provision loophole, whereby an offshore mutual fund could be organized with less than 50 percent U.S. ownership. Although the anticipated revenue gain had been modest, the provisions actually gained significant revenue—much to the surprise of the tax writers—from industry that found that their Irish manufacturing companies and offshore finance subsidiaries were caught by the PFIC provisions. In some cases, i.e., the finance subsidiaries, the income was also subpart F income. Corporations

had difficulties in reorganizing foreign subsidiaries that were also PFICs. The section 367 rules were well understood; however, the IRS never promulgated comparable regulations under the PFIC provisions. Meanwhile, there was a concern that transactions that were tax-free under section 367 would be taxable under the PFIC provisions, even if the PFIC taint was not removed. In addition, U.S. investors made investments in foreign public companies that may be PFICs. The published financial statements did not provide sufficient information, and the foreign company did not want to incur the administrative costs to make the determination. The elimination of overlap between subpart F and PFIC solves some of these unanticipated problems. The mark-to-market election (see ¶ 946) only solves the portfolio investor problem if the foreign corporation determines that it is a PFIC.

Nonqualified funds. In the case of PFICs that are not qualified electing funds, stock held by a 10-percent shareholder in a CFC will continue to be treated as PFIC stock unless the shareholder elects under Code Sec. 1298(b)(1) (formerly Code Sec. 1297(b)(1)) to pay tax and an interest charge with respect to the stock's unrealized appreciation or the corporation's accumulated earnings.

Shareholders who cease to be subject to subpart F. If a shareholder who was subject to current tax on his share of a CFC's subpart F income ceases to be a 10-percent U.S. shareholder, for purposes of the PFIC provisions, the shareholder immediately becomes subject to the PFIC rules and his holding period for the stock of the PFIC is treated as beginning on the first day after ceasing U.S. shareholder status. As a result, for PFICs that are not qualified electing funds, earnings are not attributed to the period during which the corporation was a CFC and the PFIC provisions did not apply.

Effective date. This provision applies to tax years of U.S. persons beginning after December 31, 1997, and tax years of foreign corporations ending with or within such taxable years of U.S. persons.

Act Sec. 1121, adding new Code Sec. 1296(e); Act Sec. 1124. Law at ¶ 5367. Committee Report at ¶ 11,685.

Mark-to-Market Election

¶ 946

Background

There are exceptions to the general rule that income of a foreign corporation is subject to U.S. income tax when paid to its U.S. shareholders.

One exception applies to controlled foreign corporations (CFCs). A foreign corporation is a CFC if more than 50 percent of the corporation's stock, measured by voting power or value, is owned by U.S. shareholders. A U.S. shareholder is U.S. person who owns, directly or indirectly, at least 10 percent of the corporation's stock, measured by voting power. U.S. shareholders are taxed currently on their pro rata share of so-called subpart F income.

Another anti-deferral exception applies to passive foreign investment companies (PFICs). A foreign corporation is a PFIC if 75 percent or more of its gross income consists of passive income or 50 percent of more of the average fair market value of its assets produce, or are held for the production of, passive income. How

Background

U.S. shareholders of PFICs are taxed depends on whether the PFIC is a "qualified electing fund." If it is, electing U.S. shareholders are taxed currently on their respective shares of the PFIC's earnings but may elect to defer payment of tax on income not currently received, subject to an interest charge. If a PFIC is nonqualified fund, U.S. shareholders are taxed on realized PFIC income and charged interest on deferred, unrealized income.

A foreign corporation could be both a CFC and a PFIC. In such a case, the corporation's 10-percent shareholders would be subject to overlapping anti-deferral provisions.

Election allowed.—A U.S. shareholder of a PFIC may make a mark-to-market election with respect to the stock of the PFIC if such stock is marketable. Under the election, any excess of the fair market value of the PFIC stock at the close of the tax year over the shareholder's adjusted basis in the stock is included in the shareholder's income. The shareholder may deduct any excess of the adjusted basis of the PFIC stock over its fair market value at the close of the tax year. However, deductions are limited to the net mark-to-market gains on the stock that the shareholder included in income in prior tax years, or so-called "unreversed inclusions."

Marketable stock. For purposes of the election, PFIC stock is marketable if it is regularly traded on (1) a national securities exchange that is registered with the SEC, (2) the national market system established under Section 11A of the Securities and Exchange Act of 1934, or (3) an exchange or market that the IRS determines has rules sufficient to ensure that the market price represents a legitimate and sound fair market value. To the extent provided in regulations, PFIC stock is also considered marketable if the PFIC offers for sale, or has outstanding, stock of which it is the issuer and which is redeemable at its net asset value in a manner comparable to a U.S. regulated investment company (RIC). To the extent provided in regulations, options on stock treated as marketable are also considered marketable.

PFIC stock owned by a RIC. PFIC stock is treated as marketable if it is owned directly or indirectly by a RIC that is offering for sale, or has outstanding, stock that it issued and that is redeemable at its net asset value. To the extent provided in regulations, PFIC stock owned by any other RIC is also treated as marketable if the RIC publishes net asset valuations at least annually. Amounts included in income under the election are treated as a dividends.

Basis adjustments. A shareholder's adjusted basis of PFIC stock is increased by the income recognized under the mark-to-market election and decreased by the deductions allowed under the election. If a U.S. shareholder owns PFIC stock indirectly through a foreign entity, the basis adjustments apply to the basis of the PFIC in the hands of the foreign entity for the purpose of applying the PFIC rules to the tax treatment of the U.S. owner. Similar basis adjustments are made to the basis of the property through which the U.S. persons hold the PFIC stock.

Source and character of income and deductions. Income recognized under the mark-to-market election and gain on the sale of PFIC stock with respect to which an election is made is treated as ordinary income. Deductions allowed under the election and loss on the sale of PFIC stock with respect to which an election is made, to the extent that the amount of loss does not exceed the net mark-to-market gains previously included, are treated as ordinary losses. The source of any income

or losses is determined as if the amount were gain or loss from the sale of stock in the PFIC.

Constructive ownership of PFIC stock. PFIC stock owned directly or indirectly by or for a foreign partnership, trust or estate is treated as owned proportionately by the partners or beneficiaries. U.S. persons treated as owning PFIC stock under the constructive ownership rules may make the mark-to-market election, and any disposition of PFIC stock by an intervening owner is treated as a disposition of the stock by the U.S. person who is the ultimate owner.

PFIC stock owned by a CFC. A controlled foreign corporation (CFC) that owns stock in a PFIC is treated as a U.S. person that may make the mark-to-market election. Amounts includible in the CFC's income under the election are treated as foreign personal holding company income; deductions are allocable to foreign personal holding company income. According to the Senate Finance Committee report, the source of such income or deductions is determined by the residence of the CFC.

Basis for PFIC stock acquired from a decedent. In the case of PFIC stock with respect to which a mark-to-market election was in effect on the date of the decedent's death, the person acquiring the stock from the decedent will have a basis in the stock equal to the lesser of (1) the decedent's adjusted basis in the stock immediately before death or (2) the basis determined under Code Sec. 1014 (the date-of-death value of the stock).

Nonqualified funds. The rules of Code Sec. 1291 applicable to nonqualified funds generally do not apply to a shareholder for tax years for which a mark-to-market election is in effect. If Code Sec. 1291 is applied and a mark-to-market election was in effect for any prior tax year, the shareholder's holding period for the PFIC stock is treated as beginning immediately after the last tax year of the election. However, if a taxpayer makes a mark-to-market election for PFIC stock that is a nonqualified fund after the beginning of the taxpayer's holding period for such stock, a coordination rule applies to insure that the taxpayer does not avoid the interest charge with respect to amounts attributable to periods before the election.

Effective dates. This provision applies to tax years of U.S. persons beginning after December 31, 1997, and tax years of foreign corporations ending with or within such tax years of U.S. persons.

Act Sec. 1122, redesignating Code Sec. 1296 and Code Sec. 1297 as Code Sec. 1297 and Code Sec. 1298, and adding new Code Sec. 1296; Act Sec. 1122(b), amending Code Sec. 1291(d) and Code Sec. 1291(a)(3)(A); Act Sec. 1122(c), adding Code Sec. 4982(e)(6) and Code Sec. 852(b)(10) and amending Code Sec. 852(c); Act Sec. 1122(d), amending Code Sec. 532(b)(4), Code Sec. 542(c)(10), Code Sec. 551(f), Code Sec. 1293(a)(1) and Code Sec. 1293(d) and repealing Code Sec. 1297(b)(3), as redesignated; Act Sec. 1122(e). Law at ¶ 5183, 5185, 5187, 5263, 5363, 5365, 5367, 5369, 5371, and 5539. Committee Reports at ¶ 11,690 and 11,715.

Valuation of Assets for PFIC Determination

¶ 948

Background

A passive foreign investment company (PFIC) is a foreign corporation that meets either passive income or passive assets thresholds. The passive income

Background

threshold is met if 75 percent or more of corporation's gross income for the tax year is passive. The assets test is met if 50 percent or more of the average fair market value of the corporation's assets consist of assets that either produce or are held for the production of passive income. Under prior law, in applying the PFIC assets test, the assets of a PFIC that is also a CFC are measured using adjusted basis instead of fair market value. Non-CFC PFICs may also make an irrevocable election to use adjusted basis.

PFIC asset test for publicly traded corporations.—In connection with other simplification provisions relating to passive foreign investment companies (PFICs) (see ¶ 944 and 946, above), for purposes of applying the PFIC assets test, the assets of all PFICs that are publicly traded are measured using a fair market value computation. Thus, a publicly traded foreign corporation is a PFIC if the fair market value of its passive income-producing assets equals or exceeds 50 percent of the sum of the market value of its outstanding stock plus its liabilities.

Application of the assets test to foreign corporations that are not publicly traded is unchanged by the Act. Thus, nonpublicly traded controlled foreign corporations (CFCs) that are also PFICs continue to measure assets using adjusted basis while other nonpublicly traded foreign corporations continue to use fair market value unless they elect to use adjusted basis.

Publicly traded corporation. The stock of a foreign corporation is publicly traded if it is regularly traded on a national securities exchange that is registered with the Securities and Exchange Commission, the national market system established under section 11A of the Securities and Exchange Act of 1934, or any other exchange or market identified by the Treasury that is sufficiently regulated to ensure a sound determination of fair market value. Also, according to the Conference Committee Report, the corporation's stock must be publicly traded on each of the quarterly measurement dates under the PFIC asset test in order for this provision to apply to the corporation.

Effective date. This provision applies to tax years of U.S. persons beginning after December 31, 1997, and to tax years of foreign corporations ending with or within such tax years of U.S. persons.

Act Sec. 1123(a), amending Code Sec. 1297, as redesignated and amended by Act Sec. 1122, by adding Code Sec. 1297(e); Act Sec. 1123(b), amending Code Sec. 1297(a); Act Sec. 1124. Law at ¶ 5369. Committee Report at ¶ 11,695.

FOREIGN SALES CORPORATIONS

Computer Software Qualifying as FSC Export Property

¶ 950

Background

The Internal Revenue Code provides export incentives through the use of a Foreign Sales Corporation (FSC) that is incorporated in a qualifying offshore jurisdiction. Under the FSC rules, a portion of the FSC's foreign trade income is exempt from U.S. tax. Dividends from the FSC to a domestic parent corporation are also not taxed, under a 100 percent dividends received deduction, to the extent of the exempt foreign trade income.

Background

In general, foreign trade income refers to receipts generated from the sale, exchange, or lease of export property. Export property generally excludes intangible assets, such as patents, trademarks, formulae, and goodwill. Copyrighted articles, such as a book or mass-market computer software, that are sold without the right to reproduce it for external use are not considered to be within the list of excluded intangible property and, therefore, can qualify as export property.

However, with respect to copyrights (as opposed to copyrighted articles) under prior law, copyrights to films, tapes, records, and similar reproductions *could* qualify as export property, but copyrights to books or computer software *could not* qualify as export property (Temp. Reg. § 1.927(a)-1T(f)(3)). This rule served to deny FSC export benefits on sales or licenses of software that also granted to the foreign purchaser or licensor reproduction rights.

Software licensed for reproduction abroad.—In an effort to extend the Foreign Sales Corporation (FSC) tax benefits to software companies, computer software may now be treated as export property, even if the sale or license agreement permits reproduction of the software abroad. This rule would negate the current rule of Temp. Reg. § 1.927(a)-1T(f)(3), which excludes such sales or licenses of software from the definition of export property and, therefore, denies FSC export benefits to the income derived from such transactions.

In administering the new rule, the intention of Congress expressed in the Senate Committee Report is that the term "software" be interpreted broadly in order to accommodate future technological changes and preserve the FSC benefits now extended by the Act to computer software transactions with rights to reproduce the software. The committee report specifically stated that no inference should be drawn from this provision as to whether, prior to the effective date of the Act, computer software licensed for reproduction abroad could qualify as export property.

PRACTICAL ANALYSIS. Paul Bodner, Esq., Great Neck, N.Y., observes that technology that was not contemplated when the tax law was drafted poses significant tax classification problems. When one goes to a store and "buys" shrink-wrapped computer software, such as word processing software, is the acquirer buying a product or licensing the right to use intangible property? Does it make a difference if the software is obtained off the Internet? For an exporter, does it make a difference if copies of the software are reproduced in the United States and then shipped or if a master is shipped overseas and used to reproduce the product in a foreign country? Proposed Treasury Regulation § 1.861-18 analyzed the characteristics of computer software and the means of transferring rights to its use in the context of source of income. For years there have been disputes between the software industry and the IRS as to its eligibility for FSC benefits. The FSC definition of *export property,* eligible for FSC benefits specifically exclude certain intangible property such as copyrights, *other than films, tapes, records, or similar reproductions.* Temporary Treasury Regulation § 1.927(a)-1T(f)(3) provides that although a license of a master recording tape for reproduction outside the United States is eligible for FSC benefits, standardized, mass marketed com-

puter software is only eligible for FSC benefits, if such software is not accompanied by a right to reproduce for external use. In other words, the master cannot be shipped but the copies must be made in the United States. Many practitioners believed that this distinction was incorrect. Congress agreed that computer software is virtually indistinguishable from films, tapes and records, and accordingly, it should be eligible for FSC benefits. The Committee Reports specifically state that no inference is intended regarding the qualification of computer software licensed for reproduction abroad prior to the effective date of the legislation. Microsoft is litigating this issue.

Effective date. This provision applies to gross receipts attributable to periods after December 31, 1997, in tax years ending after such date. According to the committee reports, in the case of multi-year licenses, FSC benefits are available for gross receipts attributable to the period of the license after December 31, 1997.

Act Sec. 1171(a), amending Code Sec. 927(a)(2)(B); Act Sec. 1171(b). Law at ¶ 5293. Committee Report at ¶ 11,865.

FOREIGN CURRENCY TRANSACTIONS

Personal Transactions by Individuals

¶ 953

Background

The exchange of U.S. dollars for foreign currency is considered the purchase of a capital asset under Code Sec. 1221 and, when the foreign currency is reconverted into dollars, capital gain or loss can result due to currency fluctuations relative to the dollar during the period that the foreign currency was held (Rev. Rul. 74-7, 1974-1 CB 198). In these circumstances, under Code Sec. 165(c), a capital loss is generally nondeductible unless it is incurred in connection with a trade or business or a transaction entered into for profit (*C. Quijano,* CA-1, 96-2 USTC ¶ 50,441).

The Tax Reform Act of 1986 enacted Code Sec. 988 to lay out the statutory framework for the treatment of foreign currency transactions. However, for individuals, Code Sec. 988 only applies to business or investment transactions for which related expenses are deductible in a trade or business (Code Sec. 162) or other income-producing activity (Code Sec. 212). Foreign currency transactions for personal use were not addressed specifically by the Code prior to amendment by the Act. Therefore, gain or loss on personal transactions remained subject to pre-1986 law, including the analysis set forth in Rev. Rul. 74-7.

Nonrecognition of *de minimis* gain from foreign currency transactions for personal use.—Exchange gain of an individual from the disposition of foreign currency in a personal transaction is not taxable, provided that the gain realized does not exceed $200. This simplification measure is intended to eliminate an individual's obligation to compute and report gains arising from exchanges of currency that are small in amount and that are associated with personal and business travel, as well as other nonbusiness activities.

The term "personal transaction" refers to any transaction other than one with respect to which properly allocable expenses are deductible as trade or business

expenses under Code Sec. 162 or expenses incurred in the production of income under Code Sec. 212(1) and (2). It also refers to an individual's currency exchange transactions that are entered into in connection with business travel.

Example. Jean Widget, owner of the Widget Coil and Spring Co., has a booming export business and travels overseas extensively. In June 1998, she travels to Mexico on business and charges most of her traveling expenses (i.e., hotel, meals, and incidentals) in Mexican pesos to her credit card. As a result of a falling peso between the time she incurs the expenses and the time she pays the credit card bill in dollars, she has realized exchange gain of $10. The gain is not taxable.

Gains in excess of $200 will continue to be taxed as before, meaning that such gains, even from dispositions of foreign currency in personal transactions, will generally be treated as taxable gains arising from the sale or disposition of a capital asset.

Planning Note. The law sets the nonrecognition treatment for *de minimis* gains at $200 per transaction. The law does not provide for a cumulative threshold of $200 for exchange gains from personal transactions realized throughout the entire taxable year. Accordingly, very few personal transactions should exceed the threshold amount, except in the situation where currency fluctuates dramatically during hyper-inflationary periods or as the result of a significant currency devaluation relative to the dollar.

The tax treatment of capital losses arising from personal transactions involving foreign currency is unaffected. The House Ways and Means Committee Report notes that, under Code Sec. 165(c), such losses typically are not deductible by individuals.

Effective date. The provision applies to tax years beginning after December 31, 1997.

Act Sec. 1104(a), amending Code Sec. 988(e); Act Sec. 1104(b). Law at ¶ 5311. Committee Report at ¶ 11,630.

SOURCE OF INCOME

Stock and Securities Trading Safe Harbor

¶ 955

Background

Foreign corporations and nonresident aliens that trade stocks or securities for their own accounts will, if certain safe harbor requirements are met, not be treated as engaged in a U.S. trade or business with respect to their trading activities. This generally means that the trading income will not be "effectively connected" income.

A foreign corporation qualifies for the safe harbor only if it is not a dealer in stock or securities. Also, prior to the Act, if the corporation's principal activity was securities trading for its own account, it must not have had its principal office in the United States. A similar rule applied to securities trading partnerships through which foreign persons invested in U.S. stock or securities. The location of a foreign entity's principal office generally was determined by the place where administrative functions were performed rather than the place where the entity's management or investment decisions were made.

Principal office requirement repealed.—The Act repeals the requirement that a foreign entity whose principal business is stock or securities trading must locate its principal office outside of the United States in order to qualify for the safe harbor rule of Code Sec. 864(b)(2)(A)(ii). That provision, and its regulatory extension to partnerships, permits the entity (or its nonresident investors in the case of a partnership) to treat income derived from stock or securities trading on its own account as not effectively connected to a U.S. trade or business.

Congress repealed the principal office requirement because it did not advance any important tax policy and was easily circumvented by having certain administrative functions performed abroad.

Effective date. The provision is effective for tax years beginning after December 31, 1997.

Act Sec. 1162(a), amending Code Sec. 864(b)(2)(A)(ii); Act Sec. 1162(b). Law at ¶ 5277. Committee Report at ¶ 11,840.

Foreign Vessel Crew Member

¶ 965

Background

Under prior law, a nonresident alien's presence in the United States as a regular crew member of a foreign vessel was taken into account for purposes of determining whether the individual was treated as a resident alien for U.S. tax purposes, even though such individual may not have been permitted to leave the vessel during those periods. Also, under prior law, a nonresident alien individual who earned more than $3,000 of wages while the foreign vessel was within U.S. territory was subject to income taxation by the United States. Although special rules applied to exclude gross income derived by a nonresident alien individual from the international operation of a ship if the individual's country of residence provided a reciprocal exemption for U.S. residents, this exclusion did not apply to income from personal services performed by an individual crew member on board a ship.

Foreign vessel crew member earnings treated as foreign source income.—Generally, the compensation earned by a foreign vessel crew member for services performed in the United States is treated as foreign-source income. More specifically, the compensation for labor or services performed by a nonresident alien in connection with the individual's temporary presence in the United States as a regular member of the crew of a foreign vessel engaged in transportation between the United States and a foreign country or possession of the United States is treated as foreign-source income that is exempt from U.S. income and withholding tax. However, such income is not treated as foreign-source income for purposes of applying the group-term life insurance rules of Code Sec. 79, accident and health plan rules of Code Sec. 105, and pension plan rules of subchapter D of the Code. Thus, as the Senate Committee Report provides, foreign vessel crew members are not excluded for purposes of applying the minimum participation standards of Code Sec. 410 to a plan of the employer.

The special rule of Code Sec. 863(c)(2)(B) regarding personal service income with respect to transportation that begins in the United States and ends in a U.S. possession (or vice versa) only applies to a U.S. citizen or resident.

Determining residency. For purposes of determining whether an individual is a U.S. resident under the substantial presence test of Code Sec. 7701(b)(3), special rules apply for determining "presence" with respect to foreign vessel crew members. Under the rules, the days that such individual is present as a member of the regular crew of a foreign vessel are disregarded unless the individual is otherwise engaged in any trade or business in the United States on those days.

Effective date. The provision that treats remuneration of nonresident aliens engaged in international transportation services as foreign-source income generally applies to remuneration for services performed in tax years beginning after December 31, 1997. However, the provision that disregards days that a foreign vessel crew member is temporarily present in the United States when determining residency applies to tax years beginning after December 31, 1997.

Act Sec. 1174(a)(1), amending Code Sec. 861(a)(3); Act Sec. 1174(a)(2), amending Code Sec. 863(c)(2)(B); Act Sec. 1174(b)(1), adding Code Sec. 7701(b)(7)(D); Act Sec. 1174(b)(2), amending Code Sec. 7701(b)(7)(A); Act Sec. 1174(c). Law at ¶ 5273, 5275, and 5745. Committee Report at ¶ 11,880.

TRANSFERS TO FOREIGN ENTITIES

Repeal of Code Sec. 1491 Excise Tax

¶ 968

Background

Prior to repeal by the Act, Code Sec. 1491 imposed a 35-percent excise tax on transfers of property by a U.S. person to a foreign corporation as paid-in surplus or as a contribution to capital. The excise tax was also imposed on any transfer of property by a U.S. transferor to a foreign partnership, estate, or trust.

Tax-free exchanges, gifts, and sales with deferred realization of gain are examples of transactions that were within the scope of Code Sec. 1491. The excise tax was equal to 35 percent of the excess of the property's fair market value over the sum of the transferor's adjusted basis in such property plus any gain recognized at the time of the transfer.

Certain transfers were excluded from the excise tax by Code Sec. 1492, which is also repealed. The excluded transfers included:

(1) transfers to certain tax-exempt organizations;

(2) transfers to a foreign corporation that were subject to the gain recognition or otherwise covered by the rules of Code Sec. 367;

(3) transfers for which the taxpayer elected to apply the principles of Code Sec. 367; or

(4) transfers that the taxpayer elected, under Code Sec. 1057, to treat as taxable sales.

Transfers subject to Code Sec. 1491 had to be reported on Form 926 (Return by a U.S. Transferor of Property to a Foreign Corporation, Foreign Estate or Trust, or Foreign Partnership) on the day of the transfer. Any excise tax due on the transfer was computed on Form 926 and was required to be paid on the day of the transfer. The elections described above to apply the principles of Code Sec. 367 or to recognize gain under Code Sec. 1057 also had to be reported on Form 926.

Background

In addition to the excise tax, Code Sec. 1494(c) set forth a harsh penalty for failure to properly report a transfer that was within the scope of Code Sec. 1491. The penalty could equal up to 35 percent of the *gross value* of the property transferred, and additional penalties could accrue for continued failure to comply. The controversial penalty could apply just by virtue of the transfer being "described in Code Sec. 1491," whether or not the transfer actually was subject to the excise tax. It could apply, for instance, to transfers described in Code Sec. 1491, but excluded under Code Sec. 1492.

Recognizing the reporting burdens and potentially drastic penalties wrought by Code Sec. 1494(c), the IRS attempted to narrow the scope of reportable transfers in Notice 97-18. The Notice limited the reporting requirement by waiving reporting of transfers in which the U.S. transferor immediately recognized gain and did not have a significant interest in the transferee immediately after the transfer. It also excluded certain transfers that were already required to be reported under another Code section from the potential imposition of the Code Sec. 1494(c) penalty tax.

Excise tax on transfers to foreign entities replaced with gain recognition.—The Act repeals the 35-percent excise tax imposed by Code Sec. 1491 on transfers of property by a U.S. person to a foreign corporation as paid-in surplus or as a contribution to capital. The excise tax applied as well to transfers to a foreign partnership or to a foreign estate or trust. Also repealed is the controversial and draconian penalty of Code Sec. 1494(c), added by the Small Business Job Protection Act of 1996 (P.L. 104-188), for failure to report transfers covered by Code Sec. 1491. Finally, Code Secs. 1057 and 1492, which excluded certain transfers from the excise tax or provided an election to exclude such transfers, are also repealed.

The Code Sec. 1491 excise tax was introduced into the Code in 1932 and has long served as a backstop for the income tax with respect to transfers of appreciated property to entities outside of the U.S. taxing jurisdiction in nontaxable transactions. Without the excise tax, built-in gain in the property could ultimately escape U.S. taxation.

With the repeal of Code Sec. 1491, Congress has generally adopted a policy of recognizing gain on transactions that previously qualified for nonrecognition treatment but fell subject to the 35-percent excise tax. While the excise tax applied mechanically and presented a trap for the unwary, particularly in the partnership area, Congress anticipates the development of a regulatory regime to spell out the transfers that should and should not be subject to gain recognition.

Transfers to foreign trusts and estates. Any transfer of property by a U.S. person to a foreign trust or estate is now taxable, except to the extent provided by regulation. Such a transfer is treated as a sale or exchange of the property for its fair market value (FMV). The U.S. transferor must recognize gain equal to the excess of the property's FMV over its adjusted basis in the hands of the transferor. The gain recognition rule does not apply if the U.S. transferor (or other person) is considered to be the owner of the trust under the grantor trust rules.

In addition, where a domestic trust becomes a foreign trust, all trust assets are considered to be transferred to a foreign trust. Thus, appreciated property owned by the trust will be deemed sold on the date that the trust is converted from domestic to foreign, and gain must be recognized by the trust on that date.

Transfers to foreign corporations. All capital contributions and transfers of paid-in surplus to foreign corporations are now brought with the rules of Code Sec. 367. Thus, to the extent that a contribution to the capital or paid-in surplus of a foreign corporation was previously subject to the Code Sec. 1491 excise tax but was not within the scope of Code Sec. 367, such a transfer may now be a taxable transaction under regulations to be prescribed by the Treasury.

Transfers to partnerships with foreign persons. In lieu of the Code Sec. 1491 excise tax on transfers of property to foreign partnerships, the Act empowers the Treasury Department to write regulations denying the normal nonrecognition treatment of Code Sec. 721 on partnership contributions by a U.S. partner in circumstances where gain inherent in the property contributed ultimately will be recognized by a foreign person. Thus, it appears that Congress has mandated a regulatory regime that will "look through" the partnership to determine whether the gain will be allocated to a foreign partner, presumably as the result of either a sale of the property by the partnership or a subsequent in-kind distribution of the property to a foreign partner.

Caution. This provision concerning denial of nonrecognition treatment for partnership contributions is not necessarily limited to transfers to foreign partnerships. Under the literal text of the law as amended, the measure potentially could apply to a domestic partnership with foreign partners. The situations in which gain will be recognized is to be set forth by the Treasury in regulations.

Transfers of insurance policies, etc. To the extent provided by regulations, nonrecognition treatment on exchanges of life insurance policies, endowment contracts, or annuities under Code Sec. 1035 will not apply if the exchange has the effect of transferring property to a foreign person.

PRACTICAL ANALYSIS. D. Kevin Dolan, of Weil, Gotshal & Manges' Washington, D.C. office (former IRS Associate Chief Counsel, Technical and International) notes that the repeal of the Code Sec. 1491 excise tax is long overdue. In the context of transfers to partnerships and corporations, the excise tax was not justified by policy concerns. Subchapter K adequately deals with attempts to shift built-in appreciation among partners (e.g., Code Sec. 704(c)), and Code Sec. 367 addresses tax avoidance issues in the corporate area. Code Sec. 1491 served mainly as a trap for the unwary, and its replacement with IRS regulatory authority over these areas is a welcome change.

Effective date. The repeal of Code Secs. 1491-1494 and new provisions concerning transfers to foreign entities are effective on August 5, 1997.

Act Sec. 1131(a), repealing Code Secs. 1491-1494 (Chapter 5); Act Sec. 1131(b), adding Code Sec. 684; Act Sec. 1131(b)[(c)](1), redesignating Code Sec. 1035(c) as subsection (d) and adding new subsection (c); Act Sec. 1131(b)[(c)](2), adding Code Sec. 367(f); Act Sec. 1131(b)[(c)](3), adding Code Sec. 721(c); Act Sec. 1131(c)[(d)], amending Code Sec. 814(h), repealing Code Sec. 1057, and striking Code Sec. 6422(5). Law at ¶ 5127, 5211, 5221, 5253, 5325, 5335, 5409–5415, and 5671. Committee Report at ¶ 11,735.

Transfers of Intangibles

¶ 969

Background

A transfer of intangible property by a U.S. person to a foreign corporation in exchange for stock or as part of a corporate reorganization results in a deemed sale of the property for a stream of royalty payments received over the useful life of the intangible. Income inclusions under this provision are determined annually (and at the time of disposition of the property by the foreign corporation). The deemed royalty amounts must be arm's length and must be commensurate with the annual income attributable to the intangible. The deemed amounts are treated as ordinary income. These rules remain unchanged by the Act.

Under prior law, the amount included in gross income under the deemed royalty provision was U.S.-source income. Also, no specific provision existed under prior law with respect to the transfer of intangible property to a foreign partnership. The transfer was a transaction subject to the Code Sec. 1491 excise tax, however.

Treatment of deemed royalties on transfers to corporations or partnerships.—The treatment of deemed royalty income on transfers of intangibles to a foreign corporation in exchange for stock or as part of a corporate reorganization as U.S.-source income is repealed. Thus, the deemed payments are no longer subject to a special source rule. Instead, the income will be considered as foreign-source to the extent that an actual payment made by the foreign corporation under a license or sale agreement with the transferor would be treated as foreign-source income.

Planning Note. The provision eliminates one of the disadvantages of contributing intangible property to a foreign corporation, as opposed to structuring the transaction as an actual royalty agreement. Because, prior to amendment, the deemed royalties were characterized as U.S.-source income, the income could not be used to improve the taxpayer's position under the foreign tax credit limitation formula. Under the Act, deemed royalties and actual royalties should be characterized identically for source purposes in applying the foreign tax credit limitation rules. However, other considerations such as foreign withholding taxes that may be imposed on actual royalty payments and the deductibility of actual v. deemed royalties for foreign tax purposes still must be taken into account.

Partnerships. Regulatory authority is granted to apply the Code Sec. 367(d) deemed royalty treatment in the case of a transfer of intangible property to a partnership. Accordingly, to the extent provided by regulations, such a transfer will be treated as a sale that generates deemed annual payments from the partnership to the transferor. Such payments are considered to be ordinary income, not capital gain, must be established on an arm's-length basis, and must be commensurate with the annual income attributable to the intangible.

The Senate Finance Committee Report would seem to indicate that only transfers to foreign partnerships are anticipated to be within the scope of the rule, although this term is not defined in the Code. See ¶ 467 for guidance in the Act concerning the distinction between U.S. and foreign partnerships.

Effective date. This provision is effective on August 5, 1997. According to the Senate Finance Committee Report, this should be interpreted to mean that the

provision is effective for transfers made and royalties deemed received after August 5, 1997.

Act Sec. 1131(b)[(c)](4) and (5), amending Code Sec. 367(d)(2)(C), adding Code Sec. 367(d)(3), and adding Code Sec. 721(d); Act Sec. 1131(d)[(e)]. Law at ¶ 5127 and 5221. Committee Report at ¶ 11,735.

Statute of Limitations

¶ 971

Background

The normal statute of limitations does not apply with respect to tax imposed on outbound property transfers under Code Sec. 367(a), (d), or (e) if the U.S. person making the transfer fails to timely report the transfer, as required by Code Sec. 6038B. Such transfers must be reported on Form 926, which must be filed by the U.S. person along with its tax return for the tax year including the date of the transfer. Where Form 926 is not timely completed and filed, the limitations period runs until three years after the date on which the Treasury is properly notified of the exchange or distribution.

Under prior law, no similar extension of the statute of limitations applied in the case of tax imposed on transfers to foreign partnerships, trusts, or estates. Nor was there an extension of the limitations period with respect to tax obligations that may be covered by other information reporting requirements concerning foreign entities, such as information on controlled foreign corporations required to be reported on Form 5471.

Extended statute of limitations where foreign information required.— The Act strengthens the information reporting requirements relating to foreign entities by suspending the running of the statute of limitations until the information is reported. Specifically, the time for assessment of tax "with respect to any event or period to which such information relates" will continue until the date that is three years after the date on which required information is furnished to the government.

This rule previously applied to the reporting of certain transfers to foreign corporations that were taxable under Code Sec. 367, but it now applies to events or periods for which reporting is required under all of the following Code sections:

Code Sec. 6038—Information Reporting with Respect to Certain Foreign Corporations and Partnerships

Code Sec. 6038A—Information with Respect to Certain Foreign-Owned Corporations

Code Sec. 6038B—Notice of Certain Transfers to Foreign Persons

Code Sec. 6046—Returns as to Organization or Reorganization of Foreign Corporations and as to Acquisitions of Their Stock

Code Sec. 6046A—Returns as to Interests in Foreign Partnerships

Code Sec. 6048—Information With Respect to Certain Foreign Trusts

Effective date. This provision is effective for information the due date for the reporting of which is after August 5, 1997.

Act Sec. 1145(a), amending Code Sec. 6501(c)(8); Act Sec. 1145(b). Law at ¶ 5675. Committee Report at ¶ 11,775.

FOREIGN TRUSTS

Residency of Trusts

¶ 973

Background

Prior to the enactment of the Small Business Job Protection Act of 1996 (P.L. 104-188), a trust was treated as foreign if it was not subject to U.S. taxation on its income from foreign sources, i.e., income other than U.S.-source income or income effectively connected to a U.S. trade or business. Thus, trusts were considered to be foreign trusts if they were taxed in the same manner as nonresident alien individuals. All other trusts were treated as domestic trusts.

With the passage of the Small Business Job Protection Act, Congress enacted new Code Sec. 7701(a)(30)(E) and Code Sec. 7701(a)(31) to provide rules for determining the residency of trusts. The statutory distinction between U.S. and foreign trusts, described below, provided objective criteria for determining trust residence. Congress viewed this as preferable to the prior law subjective treatment of trusts, which applied the distinction between resident and nonresident alien individuals by analogy to trusts.

Transitional rule for definition of trust residency.—The new law gives the Treasury the authority to prescribe rules under which nongrantor trusts can continue to be treated as U.S. trusts, even though such trusts would be considered as foreign trusts under the two-part test of Code Sec. 7701(a)(30)(E). The Code defines a trust as a U.S. person if both (1) a U.S. court can exercise primary supervision over the administration of the trust and (2) one or more U.S. fiduciaries have the authority to control all substantial decisions of the trust. A trust that does not satisfy both criteria is a foreign trust. (See ¶ 975, below, for a technical modification to the definition of trust residency.)

The statutory definition of a U.S. resident trust was added by the Small Business Job Protection Act of 1996 (P.L. 104-188) ("Small Business Act") and is generally effective for tax years beginning after 1996. Because many trusts that were treated as U.S. trusts prior to the 1996 Small Business Act would be treated as foreign trusts under the current statutory definition, an election that allows trusts to choose continued U.S. tax treatment is provided under the Act.

The Act contains two distinct, but largely overlapping, provisions that address the issue and provide an election for continued U.S. tax treatment. Both provisions will apply only to the extent provided by Treasury regulations.

The first provision amends the 1996 Small Business Act. It authorizes the Treasury to permit the election of continued U.S. treatment by a trust that was in existence on August 20, 1996, and was considered a U.S. person on August 19, 1996.

The second provision is more restrictive in that it is expressly limits the election of continued U.S. treatment, as provided by regulations, to a "reasonable"

transitional period following the August 20, 1996, enactment of the 1996 Small Business Act. Other conditions under this provision are that the trustee has not opted to treat the trust as a foreign trust under the election provided by Sec. 1907(a)(3)(B) of the 1996 Small Business Act, that the trust makes modifications necessary to be treated as a U.S. person before the expiration of the reasonable period, and that the trust complies with other regulatory requirements.

Planning Note. While the Act gives the Treasury the responsibility to define the criteria under which an election for continued treatment as a U.S. trust can be made, the second provision described above seems to mirror the conditions set forth in Notice 96-65, I.R.B. 1996-52. The Notice gives domestic trusts additional time to make adjustments in order to retain domestic trust status under the new statutory definition, provided the following conditions are met: (1) the trustee must initiate modification of the trust to conform with the domestic trust criteria by the due date (including extensions) for its 1997 tax return; (2) the trustee must complete the modification within two years of the return due date; and (3) the trustee must attach a statement to the trust's 1997 tax return entitled "Election to Rely on Notice 96-65 to File as a Domestic Trust."

Effective date. Both provisions concerning election of continued treatment as a U.S. resident trust apply to tax years beginning after December 31, 1996, or, at the election of the trustee, to tax years ending after August 20, 1996.

Act Sec. 1161(a), amending Act Sec. 1907(a)(3) of the Small Business Job Protection Act of 1996; Act Sec. 1161(b); Act Sec. 1601(i)(4); Act Sec. 1601(j). Law at ¶ 7040 and 7076. Committee Report at ¶ 11,835.

¶ 975

Technical corrections to residency definition.—The two-part test set forth at ¶ 973, above, for determining whether a trust is a U.S. or foreign trust is modified by substituting the term "United States persons" for "United States fiduciaries." Thus, a trust is treated as a U.S. person so long as a U.S. court is able to exercise primary supervision over administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trusts, regardless of whether such persons are trust fiduciaries.

In addition, the Act clarifies that, in applying the general rule that trusts or estates compute taxable income in a manner similar to individuals, foreign trusts or estates are deemed not to be present or resident in the United States at any time.

Effective date. These technical corrections apply to tax years beginning after December 31, 1996, or at the election of the trustee, to tax years ending after August 20, 1996.

Act Sec. 1601(i)(3)(A), amending Code Sec. 7701(a)(30)(E)(ii); Act Sec. 1601(i)(3)(B), amending Code Sec. 641(b). Law at ¶ 5745. Committee Report at ¶ 13,720.

Transfers to Foreign Grantor Trusts

¶ 977

Background

A U.S. person who transfers property to a foreign trust that has U.S. beneficiaries generally is treated as the owner of the portion of the trust attributable to

Background

such property. This rule does not apply to transfers in exchange for fair market value consideration. However, in determining whether the fair market value exception will apply, obligations of related persons are not taken into account. Prior to the Taxpayer Relief Act of 1997, related persons, termed "persons described" in the law, included the following: the trust, any grantor or beneficiary of the trust, and certain persons related to any grantor or beneficiary.

Fair market value exception to foreign grantor trust rules clarified.—For purposes of determining whether the transfer by a U.S. person to a foreign trust with U.S. beneficiaries is made in exchange for fair market value consideration, the obligations of the trust owner and certain persons related to the trust owner are not taken into account. Thus, trust owners (and related persons) join trust grantors and beneficiaries as "persons described" in Code Sec. 679(a)(3)(C). The obligations of described persons are disregarded in applying the fair market value exception to the rule that treats a U.S. transferor of property to a foreign trust with U.S. beneficiaries as the trust owner.

Effective date. This technical correction applies to transfers of property after February 6, 1995.

Act Sec. 1601(i)(2), amending Code Sec. 679(a)(3)(C)(ii) and (iii). Law at ¶ 5209. Committee Report at ¶ 13,715.

INFORMATION REPORTING

Foreign Partnership Return Requirement

¶ 981

Background

Pursuant to Reg. § 1.6031-1(c), any partnership engaged in a trade or business in the United States or having U.S.-source income is required to file a partnership return. The filing requirement applies regardless of the location of the partnership's principal place of business and regardless of whether all partners are nonresidents. Partnerships with no business in the United States and no U.S.-source income generally are not required to file a return.

Under Code Sec. 6231(f), failure to file a return results in the denial of losses or credits to all partners in the case of a partnership that either keeps its books or records outside of the United States or has a nonresident tax matters partner.

Return requirement for foreign partnerships codified.—The Act codifies the requirements for foreign partnerships to file a partnership return (Form 1065—U.S. Partnership Return of Income), which had not been specifically provided in the Code, but rather was contained only in Reg. § 1.6031-1(c) and (d). As amended, the Code provides that a foreign partnership must file a return if it has gross income that is either U.S.-source or effectively connected with a U.S. trade or business. Treasury is granted authority to make exceptions to the filing requirement by regulation.

If a partnership that maintains books and records outside of the United States or that has a nonresident tax matters partner fails to properly file a return, all

partners will be denied their shares of partnership deductions, losses, and credits. Under prior law, the denial was limited to allocations of losses and credits.

Effective date. This provision applies to tax years beginning after August 5, 1997.

Act Sec. 1141(a), adding Code Sec. 6031(e); Act Sec. 1141(b), amending Code Sec. 6231(f); Act Sec. 1141(c). Law at ¶ 5581 and 5637. Committee Report at ¶ 11,755.

Controlled Foreign Partnerships

¶ 983

Background

U.S. owners with a controlling interest in a foreign corporation are subject to extensive annual information reporting requirements concerning the corporation's location, assets, liabilities, business activities, related-party transactions, and ownership structure. Prior to the Act, failure to complete and file the required information return resulted in penalties of $1,000 for each tax year for which information is not reported. If such failure continued for more than 90 days after notification by the Treasury, an additional $1,000 penalty applied for each 30-day period (or portion thereof) of continued noncompliance after expiration of the 90-day period. The maximum amount of additional penalties that could be imposed was $24,000.

Prior to the Act, no similar systematic reporting requirements and penalty regime existed with respect to foreign partnerships. Such information would, under prior law, be provided to some degree by foreign partnerships required to file a partnership return where the partnership had U.S.-source income or was engaged in a U.S. trade or business.

CFC information reporting requirements applied to partnerships and penalties increased.—Detailed rules for information reporting, similar to the information reporting rules for controlled foreign corporations (CFCs), now apply to controlled foreign partnerships. Under the new provision, a U.S. partner that controls a foreign partnership is required to file an annual information return. Presumably, the return for reporting information on foreign partnerships will be similar in scope to Form 5471 (Information Return of U.S. Persons With Respect To Certain Foreign Corporations).

Information to be reported. Specifically, the Act anticipates that the IRS will require information on, but not necessarily limited to, the following:

(1) the name, the entity's principal place of business and nature of its business, and the country in which the partnership is organized;

(2) a balance sheet for the partnership listing assets, liabilities and capital;

(3) transactions engaged in by the partnership with the controlling U.S. partner, with other entities controlled by that partner, or with other partners having at least a 10-percent interest in partnership capital or profits; and

(4) the identity and address of U.S. persons holding at least a five-percent interest in the partnership, along with the nature of their partnership interest.

Control defined. A U.S. partner controls a foreign partnership if the partner holds, directly or indirectly, a greater than 50-percent interest in the capital, profits, or, to the extent provided in the regulations, deductions or losses of the partnership. In determining whether control exists by virtue of an indirect interest, the constructive stock ownership rules of Code Sec. 267(c) will be applied.

Control by 10-percent partners. Where there is no single controlling partner, but the partnership is controlled by several U.S. persons each holding at least a 10-percent interest in the partnership, then the Treasury may require information to be reported by each such U.S. partner. Information that may be required under this rule includes information concerning the partner's interest and the partner's allocation of partnership items.

Increase in penalty amounts. For both controlled foreign partnerships and CFCs, failure to comply with these reporting requirements will result in a $10,000 penalty. This penalty applies for each tax year of noncompliance. If noncompliance continues for more than 90 days after Treasury notification, additional penalties of $10,000 will apply for each 30-day period (or portion thereof) after expiration of the 90-day period during which the U.S. person does not correct its failure to file a proper return. These additional penalties are capped at $50,000.

Effective date. This provision is effective for annual accounting periods of foreign partnerships beginning after August 5, 1997.

Act Sec. 1142(a), amending Code Sec. 6038(a)(1); Act Sec. 1142(b), amending Code Sec. 6038(e); Act Sec. 1142(c), amending Code Sec. 6038(b); Act Sec. 1142(d), adding Code Sec. 6038(a)(5); Act Sec. 1142(e), amending Code Secs. 318(b), 901(k)(4) and 6038; Act Sec. 1142(f). Law at ¶ 5115, 5283, and 5587. Committee Report at ¶ 11,760.

Changes in Ownership of Foreign Partnership

¶ 985

Background

A U.S. person that acquires or disposes of an interest in a foreign partnership, or whose proportional interest in the partnership changes substantially, is required to file an information return with respect to such event. Under prior law, no minimum or threshold interest in the partnership existed. Accordingly, even U.S. persons with small or nominal interests in foreign partnerships were subject to the reporting requirement.

Return requirements for changes in ownership of interests in foreign partnerships.—The requirement that a U.S. person report the acquisition or disposition of an interest in a foreign partnership, or a change in his proportional interest in the partnership, is modified to apply only to 10-percent partners. For sales or acquisitions, the reporting requirement applies only if the U.S. partner owns at least a 10-percent interest in the partnership either immediately prior to or after the transaction. For proportional increases or decreases in the partner's interest in the partnership, the change in ownership percentage must be reported only if the change involved a 10-percent or greater interest.

The term "10-percent interest" refers to a direct or indirect ownership interest of at least 10 percent in the partnership's capital or profits (or, to the extent provided by regulations, an allocation of at least 10 percent of the partnership's deductions or losses).

Effective date. This provision applies to transfers and ownership changes occurring after August 5, 1997.

Act Sec. 1143(a)(1), amending Code Sec. 6046A(a); Act Sec. 1143(a)(2), redesignating Code Sec. 6046A(d) as subsection (e) and adding new Code Sec. 6046A(d); Act Sec. 1143(c). Law at ¶ 5603. Committee Report at ¶ 11,765.

Penalty for Failure to Report Transfers to Foreign Entities

¶ 986

Background

Under prior law, a failure to file information returns relating to changes in ownership in a foreign partnership (Code Sec. 6046A) or to changes in ownership in the stock of a foreign corporation (Code Sec. 6046) was subject to a civil penalty of $1,000 for failure to file a return or to provide the required information with respect to the change in ownership.

Failure-to-file penalties increased.—Failure to file information returns relating to changes in ownership in a foreign partnership (Code Sec. 6046A) or to changes in ownership in the stock of a foreign corporation (Code Sec. 6046) is subject to increased penalties under the Act. As modified, a civil penalty of $10,000 applies for failure to file a return or to provide the required information with respect to the change in ownership.

If such failure continues for more than 90 days after notification by the Treasury, an additional $10,000 penalty applies for each 30-day period (or portion thereof) of continued noncompliance after expiration of the 90-day period. The maximum amount of additional penalties that can be imposed is $50,000.

Effective date. This provision applies to transfers and changes occurring after August 5, 1997.

Act Sec. 1143(b), amending Code Sec. 6679(a); Act Sec. 1143(c). Law at ¶ 5699. Committee Report at ¶ 11,765.

Transfers of Property to Foreign Entities

¶ 988

Background

U.S. persons who transfer property to a foreign corporation are required to report the transfer on Form 926 (Return by a U.S. Transferor of Property to a Foreign Corporation, Foreign Estate or Trust, or Foreign Partnership). In general, the reporting requirement applies to transfers, such as contributions to capital in exchange for stock and transfers as part of a corporate reorganization, that are covered by the gain recognition or deemed royalty provisions of Code Sec. 367. Prior to the Act, failure to furnish the required information can result in a penalty equal to 25 percent of the gain realized on the exchange.

Under prior law, no similar requirement applied to contributions to a foreign partnership. However, with the enactment of Code Sec. 1494(c) by the Small Business Job Protection Act of 1996 (P.L. 104-188), reporting was required for all transfers described in Code Sec. 1491, whether or not such transfers were subject to the 35-percent excise tax. Unlike the penalty provisions backing up reporting of

Background

transfers to foreign corporations, the penalty for failure to report the transfer to a foreign partnership was a draconian 35 percent of the *gross value* of the property transferred.

Transfers of property to foreign partnerships subject to new reporting requirements.—As part of a new set of information reporting obligations with respect to foreign partnerships, U.S. persons must report the contribution of property to a foreign partnership. The reporting requirement applies only if:

(1) the U.S. partner transferring the property holds, directly or indirectly, at least a 10-percent interest in the partnership; or

(2) the fair market value of the property contributed, when added to the fair market value of any other property transferred by such person (or a related person) to the partnership during the 12-month period ending on the date of the transfer, exceeds $100,000.

In the event of a transfer pricing adjustment that results in a deemed contribution of property to the partnership, the reporting requirement will apply, but the timing of the reporting requirement must be specified by the Treasury.

The new requirement for reporting contributions to foreign partnerships parallels the reporting of similar transfers to foreign corporations and replaces the reporting required under now-repealed Code Sec. 1494(c). See ¶ 968.

Penalty for failure to report transfers to foreign corporations and partnerships. The penalty for failure of a U.S. person to properly report a transfer to a foreign corporation or partnership is modified by the Act. As amended, the penalty is equal to 10 percent of the fair market value of the property transferred. In addition, failure to report a contribution to a foreign partnership will result in gain recognition on the transfer as if the property had been sold. The total penalty cannot exceed $100,000 unless the failure is due to intentional disregard of the reporting requirements.

Effective date. This provision applies to transfers made after August 5, 1997. In addition, taxpayers may elect to apply this provision to transfers made after August 20, 1996, in which case the reporting requirements under now-repealed Code Sec. 1494(c) will not apply.

Act Sec. 1144(a), amending Code Sec. 6038B(a)(1); Act Sec. 1144(b), redesignating Code Sec. 6038B(b) as subsection (c) and adding new Code Sec. 6038B(b); Act Sec. 1144(c), amending Code Sec. 6038B(b)[(c)](1) and adding Code Sec. 6038B(b)[(c)](3). Law at ¶ 5589. Committee Report at ¶ 11,770.

Reporting Threshold for Foreign Stock Ownership

¶ 990

Background

U.S. citizens and residents who are officers, directors, or 10-percent shareholders in a foreign personal holding company or controlled foreign corporation are required to file Form 5471 (Information Return of U.S. Persons With Respect to Certain Foreign Corporations) and designated schedules annually. These filings are required by Code Secs. 6035 and 6038.

Background

In addition, Code Sec. 6046 requires the filing of Form 5471 upon the occurrence of certain stock ownership changes in a foreign corporation. In general, under prior law, information reporting under Code Sec. 6046 would apply if the corporation had a five-percent U.S. shareholder.

Reporting threshold for stock ownership of a foreign corporation increased.—The threshold for stock ownership of a foreign corporation that triggers the information reporting requirements under Code Sec. 6046 is increased from five percent of the total value of the stock of the corporation to 10 percent of either the total value of corporate stock or the total combined voting power of all classes of stock with voting rights. Thus, as amended, Code Sec. 6046 requires information reporting on Form 5471 (Information Return of U.S. Persons With Respect To Certain Foreign Corporations) by the following persons:

(1) a U.S. citizen or resident who becomes a director or officer of a foreign corporation if a U.S. person meets the 10-percent ownership threshold;

(2) a U.S. person who, upon the acquisition of stock, meets the 10-percent ownership threshold if both the acquired stock and stock owned on the date of the acquisition are taken into account;

(3) a U.S. person who acquires stock equal to or exceeding the 10-percent ownership threshold;

(4) a person who becomes a U.S. person while meeting the 10-percent stock ownership threshold; or

(5) a person who is treated as a U.S. shareholder under Code Sec. 953(c).

Effective date. This provision is effective as of January 1, 1998. Guidance in the Senate Finance Committee Report interprets the effective date to mean that the provision is applicable to reportable transactions after December 31, 1997.

Act Sec. 1146(a), amending Code Sec. 6046(a). Law at ¶ 5601. Committee Report at ¶ 11,780.

TREATIES AND INTERNATIONAL TRADE

Treaty Benefits for Income from Hybrid Entities

¶ 992

Background

With some exceptions, the United States generally imposes a 30-percent withholding tax on U.S.-source income of nonresident aliens and foreign corporations that is not effectively connected with the conduct of a U.S. trade or business. The withholding tax is imposed on a gross basis to payments of various types of income, including interest, royalties, dividends, fees, and salaries.

Most U.S. income tax treaties either eliminate or reduce the rate of the withholding tax. The benefits under income tax treaties are available to residents of the United States and its treaty partners. For purposes of determining residency and other tax treaty principles, the United States will apply U.S. tax law to determine the classification of both domestic and foreign entities as either taxable entities or fiscally transparent entities (e.g., a partnership for U.S. tax purposes). The United States and its treaty partners may classify an entity differently—i.e.,

Background

it is a hybrid entity that one country views as fiscally transparent and another views as taxable.

In the case of hybrid entities, the interaction of a tax treaty with the domestic laws of the United States and its treaty partners could result tax planning opportunities that the U.S. government views as objectionable. For instance, by using a hybrid entity a taxpayer can, in some circumstances, obtain an exemption from tax on payments in the country of residence that are deductible in the source country. Under prior law, such payments made to a foreign taxpayer resident in a treaty country could be eligible for treaty benefits as well and be taxed at source in the United States at the favorable treaty withholding rate rather than the 30-percent rate under Code Secs. 871 and 881.

Treaty benefits for transactions involving hybrid entities limited.— The availability of reduced U.S. withholding tax under an income tax treaty for payments to hybrid entities is limited by the Act. The treaty withholding rates are typically much lower than the 30-percent rate under Code Secs. 871 and 881 applicable to payments to foreign persons of U.S.-source income that is not effectively connected to a trade or business in the United States.

Under the Act, a foreign person is not entitled to a reduced rate of withholding tax under a tax treaty on an item of income derived through a partnership (or other fiscally transparent entity) if all of the following apply:

(1) the income item is not treated by the treaty partner as an item of income to such foreign person;

(2) the foreign country does not impose tax on a distribution of the item by the U.S. entity to the foreign person; and

(3) the treaty does not contain a provision addressing the applicability of the treaty in the case of an item of income derived through a partnership.

Use of a U.S. LLC as a Canadian financing subsidiary. One purpose of the provision is to deny favorable U.S.-Canada treaty withholding rates for certain Canadian corporations that finance activities of a U.S. subsidiary through a U.S. limited liability company in a tax-advantaged manner. The financing structure is outlined in the example below, which illustrates the denial of treaty benefits under the hybrid provision and was the subject of an article in the CCH *LLC Advisor* newsletter (No. 18, 2/27/97). Congress was lobbied by U.S. companies that complained that the tax benefits gave them a competitive disadvantage versus their Canadian counterparts and views this as an example of tax avoidance that required "clarification" of the treaty. The application of the treaty with respect to hybrid entities is also reportedly under discussion by U.S. and Canadian treaty negotiators.

Example. Canco, a Canadian corporation, owns two subsidiaries in the United States. One is USco, a C corporation that performs all U.S. operating functions. The other is LLC Finance, which serves as an intermediary company and loans money to USco in order to finance its operations. (Some interests in LLC Finance are held by related Canadian persons.) LLC Finance is treated as a partnership for U.S. tax purposes and as a corporation under Canadian tax law. Interest payments from USco made to LLC Finance flow through to Canco and are treated as nontaxable dividends to Canco under

Canadian law. USco is able to claim a deduction for the interest payments made to LLC Finance.

Under prior law, Canco, a resident of Canada, would benefit from the 10% withholding rate on interest income under Article XI of the U.S.-Canada treaty, even though the income is not taxable in Canada and USco benefits from interest deductions in the United States. Under the Act, Congress intended that the 30% rate of Code Sec. 881(a) would apply to this situation.

Regulatory authority to combat other tax-efficient structures involving hybrid entities. In addition to the denial of treaty benefits in a situation meeting the three conditions listed above, the Act also gives the Treasury regulatory authority to deny treaty benefits in other contexts where income is received by, or attributable to, a fiscally transparent entity (e.g., a partnership) that is treated as fiscally nontransparent under the tax laws of the taxpayer's country of residence.

Caution. Readers should note that the Conference Committee Report expressly approves of recently issued Temp. Reg. § 1.894-1T, which adopts a similar approach to hybrid entities in the treaty context. The regulation applies to amounts paid after 1997. Congress believes that the regulation is consistent with the provision in the Act. Moreover, it feels that neither the Act provision nor the regulation represents an override of existing treaty obligations. Rather, according to the Conference Report, both the Act and Temp. Reg. § 1.894-1T "represent interpretations of U.S. treaties clarifying those situations involving hybrid entities in which taxpayers are entitled to treaty benefits and those situations in which they are not."

Effective date. This provision is effective on August 5, 1997.

Act Sec. 1054(a), adding Code Sec. 894(c); Act Sec. 1054(b). Law at ¶ 5281. Committee Report at ¶ 11,380.

Trade Provisions

¶ 993

Background

Title V of the Trade Act of 1974, as amended, authorizes the President to extend duty-free treatment under the Generalized System of Preferences (GSP) to certain designated goods imported into the United States from countries (or associations of countries such as customs unions and free trade areas) designated as beneficiary developing countries. This authorization must be renewed periodically. The current authorization expired on May 31, 1997.

Extension of duty-free treatment under the Generalized System of Preferences.—The President's authorization to extend duty-free treatment to imports of eligible articles from designated beneficiary developing countries under the Generalized System of Preferences (GSP) is extended through June 30, 1998. The provision amends Section 505 of the Trade Act of 1974 by striking "May 31, 1997" and inserting "June 30, 1998." The reauthorization applies retroactively to entries (or warehouse withdrawals for consumption) made after May 31, 1997 but before the date of enactment of the Act (August 5, 1997), of goods which would have received duty-free treatment under the GSP program had the entry or withdrawal occurred on May 31, 1997.

Given the retroactive application of this provision, refunds will be issued for duty charged on goods liquidated during this time frame upon the importer's request. In order to obtain a refund, an importer must file a request with the U.S. Customs Service within 180 days after August 5, 1997 (February 2, 1998). The request must provide the U.S. Customs Service with enough information to either locate the entry or reconstruct an entry that cannot be found.

Effective date. The provision is effective on August 5, 1997.

Act Sec. 981(a), amending Section 505 of the Trade Act of 1974; Act Sec. 981(b). Law at ¶ 7022. Committee Report at ¶ 10,945.

Chapter 10

Compliance and Tax Administration

PENALTIES

Reasonable Cause Exception Extended

¶ 1001

Background ———

A number of civil penalties can be avoided if the taxpayer establishes reasonable cause for failing to take a required action (or for taking a prohibited action). Notably, the accuracy-related penalty, imposed for negligent or substantial tax understatements, can be waived if the taxpayer shows reasonable cause for the return position causing the understatement and also shows good faith in taking that position.

Reasonable cause exceptions extended to four penalties.—A number of the civil penalties can be avoided if reasonable cause is shown for taking (or not taking) the action or return position that the taxpayer took. Four penalties have been added to the list of penalties that can be waived if the taxpayer establishes reasonable cause and good faith:

(1) failure to file a report on deductible employee contributions made to a retirement savings plan (Code Sec. 6652(g));

(2) failure to file a report on certain small business stock (Code Sec. 6652(k));

(3) failure by a foreign corporation to file a personal holding company tax return (Code Sec. 6683); and

(4) failure to make required payments for entities that elect to use a tax year other than their required tax year (Code Sec. 7519).

Reasonable cause and good faith are determined on the basis of the facts and circumstances. The most important factor in the determination is usually the extent of the taxpayer's attempt to determine the proper amount of tax liability. Reasonable cause has been found as a result of death or illness, casualty or natural disaster, incorrect substantive advice from a tax professional, and erroneous advice from the IRS.

Effective date. The new exceptions apply to tax years beginning after August 5, 1997.

Act Sec. 1281(a), amending Code Sec. 6652(g); Act Sec. 1281(b), amending Code Sec. 6652(k); Act Sec. 1281(c), amending Code Sec. 6683; Act Sec. 1281(d), amending Code Sec. 7519(f)(4)(A); Act Sec. 1281(e). Law at ¶ 5691, 5701 and 5743. Committee Report at ¶ 12,535.

Unauthorized Return Inspections

¶ 1004

Background

The IRS has long-standing policies against both browsing through and disclosing return information. Statutory civil and criminal penalties are imposed for unauthorized disclosure of returns and return information but, prior to the Taxpayer Browsing Protection Act of 1997, no statutory penalties were imposed for browsing through IRS records.

Criminal penalties for unauthorized inspection.—A new criminal penalty is imposed for willful unauthorized inspection of tax returns or return information. Criminal sanctions may be imposed against any federal employee or IRS contractor. The penalty also may be imposed against any state employee or other person who acquires the return or return information under Code Sec. 6103, which permits the use of federal return information for other government purposes such as state tax and child support collection, law enforcement, social welfare program administration, and statistical use.

Penalties. The maximum penalty is up to one year imprisonment, a fine of $1,000 and the prosecution's costs. Convicted federal employees will also lose their jobs.

Effective date. This provision applies to violations occurring on and after August 5, 1997.

Act Sec. 2(a) of the Taxpayer Browsing Protection Act, adding Code Sec. 7213A; Act Sec. 2(b) of the Taxpayer Browsing Protection Act, amending Code Sec. 7213(a)(2); Act Sec. 2(c) of the Taxpayer Browsing Protection Act. Law at ¶ 5710 and 5710A. Committee Report at ¶ 25,105.

¶ 1007

Civil damages for unauthorized inspection.—The civil penalties imposed for unauthorized disclosure of returns and return information now apply to knowing or negligent unauthorized inspection of returns and return information. Thus, a taxpayer may bring a civil action against the United States if a government employee knowingly or negligently inspects, without authorization, any return or return information pertaining to that taxpayer. The same action may also be taken against any other person who browses through returns or return information without proper authorization.

Exceptions. A taxpayer is not entitled to civil damages if the disclosure or inspection was carried out in good faith based on an erroneous interpretation of the Code's confidentiality requirements. Further, civil damages will not be awarded if the disclosure or inspection was accidental or inadvertent (as where an IRS employee erroneously enters a taxpayer identification number) or was requested by the taxpayer.

Taxpayer notification. If a person is criminally charged with unauthorized inspection or disclosure of returns or return information (see ¶ 1004), the IRS must notify the taxpayer as soon as practicable of the inspection or disclosure. Specifically, notification is required for charged violations of Code Sec. 7213(a)(1) or (2), Code Sec. 7213A(a), or 18 USC 1030(a)(2)(B).

Effective date. This provision applies to inspections and disclosures occurring on and after August 5, 1997.

Act Sec. 3(a) of the Taxpayer Browsing Protection Act, amending Code Sec. 7431(a); Act Sec. 3(b) of the Taxpayer Browsing Protection Act, redesignating Code Sec. 7431(e) as Code Sec. 7431(f), redesignating Code Sec. 7431(f) as Code Sec. 7431(g) and adding new Code Sec. 7431(e); Act Sec. 3(c) of the Taxpayer Browsing Protection Act, amending Code Sec. 7431(b); Act Sec. 3(d) of the Taxpayer Browsing Protection Act, amending Code Sec. 7431(c), Code Sec. 7431(d), and Code Sec. 7431(f) (as redesignated); Act Sec. 3(e) of the Taxpayer Browsing Protection Act. Law at ¶ 5719. Committee Report at ¶ 25,025.

Interest Abatement in Disaster Area

¶ 1009

Background

The IRS is authorized under Code Sec. 6404 to abate the unpaid portion of the assessment of any tax or any liability in respect thereof, which is excessive in amount, or is assessed after the expiration of the period of limitations, or is erroneously or illegally assessed.

Secretary's abatement of interest powers extend to Presidentially declared disaster areas.—If the Secretary of the Treasury extends the period of time for filing income tax returns, extends the period of time for paying income tax with respect to such returns, and waives any penalties relating to the failure to so file or so pay, for any individual located in a Presidentially declared disaster area, then the Secretary shall abate for such period the assessment of any interest prescribed under Code Sec. 6601. For the purposes of this section, the term "individual" does not include estates or trusts. See ¶ 1067 for the discussion of a

new provision which allows the IRS to postpone tax-related deadlines for taxpayers affected by a Presidentially declared disaster.

Effective date. Applies to disasters declared after December 31, 1996.

Act Sec. 915. Law at ¶ 7010. Committee Report at ¶ 10,620.

STATUTE OF LIMITATIONS

Refunds for Taxpayers Who Failed to File

¶ 1010

Background

Code Sec. 6511 provides that the statute of limitations on filing a refund claim is the later of three years from the date the return was filed or two years from the date the taxes were paid. If the claim for refund was filed within three years of the filing of the return, then the refund amount is limited to amounts paid within three years preceding the refund claim. If the claim was filed within two years of the time the tax was paid, then the refund is limited to the amount paid within two years preceding the claim date. These rules apply to taxpayers who challenge deficiency notices in the Tax Court and are found to be entitled to a refund.

In 1996, the U.S. Supreme Court held that the Tax Court could not refund taxes paid more than two years prior to the date on which the IRS mailed the taxpayer a notice of deficiency. The Supreme Court held that, in the Tax Court, the applicable look-back period is generally determined as though a taxpayer filed a hypothetical refund claim on the date the IRS mailed its notice of deficiency (*R.F. Lundy,* SCt, 96-1 USTC ¶ 50,035). Thus, if a hypothetical refund claim filed on the date of the mailing of the notice of deficiency would have been filed within three years from the time the return was filed, then a three-year look-back period applied. If the claim would not have been filed within that three-year period, then the look-back period was two years. Because the taxpayer in *Lundy* had not filed a return as of the date the deficiency notice was mailed, the two-year look-back period applied and the taxpayer could not recover overwithheld taxes.

Clarification of period for filing refund claims.—Taxpayers who fail to file a return as of the date the IRS mails a deficiency notice may recover in the Tax Court taxes paid during the three years preceding the IRS mailing date. In other words, a three-year look-back period has replaced the two-year look-back period established by the U.S. Supreme Court in *R.F. Lundy* (96-1 USTC ¶ 50,035) for taxpayers who file returns after the IRS has mailed a notice of deficiency.

The extension eliminates the disparate treatment between late filers (some of whom received the benefit of the three-year look-back) and nonfilers (who always had the two-year look-back), and between taxpayers who file in the Tax Court and those who file in the district courts.

Effective date. The three-year look-back rule applies to claims for refund or credit for tax years ending after August 5, 1997.

Act Sec. 1282(a), amending Code Sec. 6512(b)(3); Act Sec. 1282(b). Law at ¶ 5683. Committee Report at ¶ 12,540.

Items from Pass-Through Entities

¶ 1013

Background

Prior to the Taxpayer Relief Act of 1997, the Internal Revenue Code did not specifically address the issue of whether the statute of limitations on assessments ran from the time that a pass-through entity filed its information return or from the time that the entity's shareholders, partners, or beneficial owners filed their income tax returns. In 1993 the U.S. Supreme Court held in *S.B. Bufferd* (93-1 USTC ¶ 50,038) that the three-year limitations period for assessing the income tax liability of an S corporation shareholder ran from the date the shareholder's return was filed.

Statute of limitations for assessments.—The three-year statute of limitations on assessments begins to run at the time a pass-through entity's shareholder or other beneficial owner files an individual income tax return. The date the pass-through entity (or any other person from whom the taxpayer receives a tax attribute) files its information return has no bearing on the statue of limitations. This provision codifies the U.S. Supreme Court's decision in *S.B. Bufferd* (93-1 USTC ¶ 50,038).

> **Example.** Susan Miller owns stock in an S Corporation. The corporation timely filed its 1994 Form 1120S, U.S. Income Tax Return for an S Corporation, on March 15, 1995. On the return, the corporation reported a loss. Miller filed her 1994 individual tax return on April 15, 1995, claiming her pro rata share of the loss. On October 1, 1996, the IRS determined that the deduction was overstated and Miller agreed to extend the statute of limitations on assessments as to her Form 1040. On October 1, 1999, the IRS assesses a deficiency against Miller attributable to the 1994 pass-through loss. Despite the fact that more than three years have elapsed from the time the corporation filed its Form 1120S, the IRS is not barred from assessing a deficiency against Miller, because the limitations period is determined with reference to Miller's individual return.

Effective date. This provision is applicable to tax years beginning after August 5, 1997.

Act Sec. 1284(a), amending Code Sec. 6501(a); Act Sec. 1284(b). Law at ¶ 5675. Committee Report at ¶ 12,550.

Administrative Costs and Attorney Fees

¶ 1016

Background

Taxpayers who substantially prevail in an action brought by or against the United States involving the determination, collection or refund of any tax, interest or penalty may be awarded reasonable administrative or litigation costs. Under prior law, no time limit was specified for the taxpayer to seek an award of costs. Additionally, the procedural rules for adjudicating a denial of administrative costs were unclear.

Awarding of administrative costs procedure.—A taxpayer who prevails in an IRS proceeding must apply to the IRS for administrative costs before the 91st day after the date the final IRS determination of tax, interest or penalty was mailed to the taxpayer. In order to appeal an IRS denial of a taxpayer's application for costs, the taxpayer must petition the Tax Court within 90 days of when the IRS mails the denial.

Tax Court decisions on awards of administrative costs are reviewed in the same manner as any other Tax Court decisions (but only with respect to matters regarding those costs).

Effective date. The specified procedures and time limitations apply to civil actions and proceedings commenced after August 5, 1997.

Act Sec. 1285(a), adding Code Sec. 7430(f)(3); Act Sec. 1285(b), adding Code Sec. 7430(b)(5); Act Sec. 1285(c), amending Code Sec. 7430(f)(2); Act Sec. 1285(d). Law at ¶ 5717. Committee Report at ¶ 12,555.

LIENS AND LEVIES

Continuous Levy

¶ 1019

Background

Persons liable for any tax who do not make payment within 10 days after notice and demand by the IRS are subject to having the IRS collect the tax by levy upon all property and rights to property belonging to the taxpayer, unless there is an explicit statutory restriction on so doing. Generally, under prior law, with the exception of a levy on salary or wages, levies did not apply to property acquired after the date of the levy, regardless of whether the property was held by the taxpayer or a third party on behalf of the taxpayer. Consequently, successive seizures may have been necessary if the initial seizure was insufficient to satisfy the tax liability.

Continuous levy expanded.—The continuous levy provision has been expanded to apply not only to salary and wages but also to specified payments. Levies of up to 15 percent on all specified payments to or received by a taxpayer are continuous from the date such levy is first made until it is released, notwithstanding Code Sec. 6334, which allows levy exemptions for certain payments.

Specified payments are (1) any federal payment other than a payment for which eligibility is based on the income or assets, or both, of a payee, (2) unemployment benefits, (3) workmer's compensation, (4) the minimum levy exemption amount for wages and like payments, (5) certain public assistance payments, and (6) certain railroad annuity, railroad pension or railroad unemployment benefits.

Effective date. The expansion of the continuous levy applies to levies issued after August 5, 1997.

Act Sec. 1024(a), redesignating Code Sec. 6331(h) as (i) and adding new Code Sec. 6331(h); Act Sec. 1024(b). Law at ¶ 5663. Committee Report at ¶ 11,230.

Wage Replacement Payments

¶ 1022

Background

Under prior law, workers' compensation payments, annuity or pension payments under the Railroad Retirement Act, benefits under the Railroad Unemployment Insurance Act, unemployment benefits, and means-tested public assistance were exempt from levy.

Wage replacement payments subject to levy.—Certain specified payments will no longer be exempt from levy if the Secretary of the Treasury (or his delegate) approves the levy. Generally, specified payments are (1) any federal payment other than a payment for which eligibility is based on the income or assets or both of a payee, (2) unemployment benefits, (3) workers' compensation, (4) the minimum levy exemption amount for wages and like payments, (5) certain "means-tested" public assistance payments, and (6) certain railroad annuity, railroad pension or railroad unemployment benefits. Payments in category (1), above were and continue to be subject to levy. Payments in category (2)-(6), above, may now be subject to levy. The IRS may attach up to 15 percent of such payments under a continuous levy (see ¶ 1019).

Effective date. The extension of levy authority to wage replacement payments applies to levies issued after August 5, 1997.

Act Sec. 1025(a), redesignating Code Sec. 6334(f) as Code Sec. 6334(g) and adding new Code Sec. 6334(f); Act Sec. 1025(b). Law at ¶ 5565. Committee Report at ¶ 11,235.

TAX COURT PROCEDURE

Overpayment Determinations

¶ 1025

Background

If the IRS fails to refund an overpayment and interest as determined by the Tax Court within 120 days after the court's decision becomes final, the court may order payment. Prior to the Taxpayer Relief Act of 1997, it was unclear whether such an order was appealable or whether the Tax Court had jurisdiction over the validity or merits of certain credits or offsets made by the IRS that reduced or eliminated a taxpayer's refund.

Tax Court order to refund overpayment is appealable.—If the IRS fails to refund an overpayment within 120 days after a Tax Court decision becomes final, the order is appealable as a final decision. However, the court does not have jurisdiction over the merits or validity of credits or offsets that would reduce or eliminate the refund to which the taxpayer is otherwise entitled (e.g., IRS collection of delinquent student loans or child support).

Effective date. This provision is effective on August 5, 1997.

Act Sec. 1451(a), amending Code Sec. 6512(b)(2); Act Sec. 1451(b), adding Code Sec. 6512(b)(4); Act Sec. 1451(c). Law at ¶ 5683. Committee Report at ¶ 12,955.

Redetermination of Interest

¶ 1028

Background

Prior to the Taxpayer Relief Act of 1997, a redetermination of interest provided by certain final Tax Court decisions was sought by filing a petition with the court.

New method for seeking redetermination of Tax Court interest.—Taxpayers seeking a redetermination of interest by the Tax Court may file a motion for redetermination, rather than a petition, with the court within a year after the decision becomes final.

Effective date. The new procedure is effective on August 5, 1997.

Act Sec. 1452(a), amending Code Sec. 7481(c); Act Sec. 1452(b). Law at ¶ 5733. Committee Report at ¶ 12,960.

Employment Status Jurisdiction

¶ 1031

Background

Code Sec. 7442 lists the Tax Court's primary function as reviewer of deficiencies asserted against taxpayers by the IRS for additional income, estate, gift, excise, and private foundation taxes. The court had no jurisdiction over any other taxes or over nontax matters.

Tax Court jurisdiction expanded.—Tax Court jurisdiction has been expanded to encompass employment status determinations in limited circumstances. Where an actual controversy arises in connection with the audit of any person involving a determination by the IRS that (1) one or more individuals performing services for the taxpayer are employees of that person *or* (2) the taxpayer is not entitled to relief under Section 530 of the Revenue Act of 1978, then the court has jurisdiction to determine whether the IRS is correct. An IRS determination that could trigger jurisdiction may be made in the course of a mechanism like the employment tax early referral procedures of Announcement 96-13 (I.R.B. 1996-12) and Announcement 97-52 (I.R.B. 97-21), or as a result of a failure to agree.

There are a number of limitations on the court's jurisdiction. A petition for a Tax Court ruling may be filed only by the person for whom services are performed ("the hirer"). The hirer must file a pleading within 90 days after the IRS sends notification, by certified or registered mail, that it has made a determination. While an action is pending, the hirer is permitted to change the employment tax treatment of any individual whose status is at issue in the proceeding (or who holds a substantially similar position) and no adverse inference may be drawn from such a change.

Assessment and collection of the taxes are suspended while the employment status matter is pending before the court.

The Tax Court will review the IRS's determination *de novo*, rather than review the administrative record. Determinations of the court are binding on the parties; the decisions have the full force and effect of a Court decision and are

reviewable as decisions. Costs and fees are available to the prevailing party under the usual Code Sec. 7430 rules.

Small case procedures available. The Tax Court's small case procedures (under Code Sec. 7453) may be used in employment status cases provided:

(1) the amount of employment taxes in dispute is $10,000 or less for each calendar quarter involved, and

(2) the hirer and the court agree to use the procedures.

If the small case procedures are used, the decision may not be reviewed by any other court nor be used as precedent in any other case not involving the same hirer and the same determinations.

Statute of limitations on claim for refund. If the court determines that the hirer is entitled to a credit or refund of employment taxes but the credit or refund is prevented by operation of law (other than Code Sec. 7122 relating to compromises), then the hirer must file a claim for refund on or before the last day of the second calendar year after the calendar year in which the determination becomes final.

Example. A Tax Court decision for a refund of employment taxes paid by Hirer becomes final on October 1, 1998. Hirer must file a claim for refund on or before December 31, 2000.

Effective date. Jurisdiction is expanded on August 5, 1997.

Act Sec. 1454(a), redesignating Code Sec. 7436 as Code Sec. 7437, and adding Code Sec. 7436; Act Sec. 1454(b), adding Code Sec. 6511(d)(7), and amending Code Secs. 7421(a), 7453 and 7481(b); Act Sec. 1454(c). Law at ¶ 5681, 5715, 5721, 5723, and 5725. Committee Report at ¶ 12,985.

LITIGATION COSTS

Joint Filers

¶ 1034

Background

Persons who substantially prevail in actions brought by or against the United States in connection with any tax (including interest or penalties) may be awarded the costs they incur in connection with any administrative proceedings or litigation, provided their net worth is below a certain amount. In general, an individual must have a net worth of $2 million or less to be eligible for an award of their costs. Prior to the Taxpayer Relief Act of 1997, no explicit provision explained how the net worth calculation applied to joint filers.

Net worth threshold applies separately to each joint filer.—The $2 million net worth requirement applies separately to each joint filer in determining whether a couple is eligible to be awarded the costs they incur in litigation and administrative proceedings involving their tax liability. Thus, a married couple filing jointly may recover litigation costs if the net worth of each spouse is less than $2 million; a couple could conceivably have a net worth up to $4 million and still be eligible to receive an award of their costs. This provision codifies the Tax Court's holdings in *J.H. Swanson,* 106 TC 76, Dec. 51,155, and *K. Hong,* 100 TC 88, Dec. 48,853.

Effective date. The separate joint filer threshold applies to proceedings commenced after August 5, 1997.

Act Sec. 1453(a), adding Code Sec. 7430(c)(4)(D); Act Sec. 1453(b). Law at ¶ 5717. Committee Report at ¶ 12,965.

Estates and Trusts

¶ 1037

Background

Persons who substantially prevail in actions brought by or against the United States in connection with any tax (including interest or penalties) may be awarded the costs they incur in connection with any administrative proceedings or litigation provided that they meet certain net worth requirements. Prior to the Taxpayer Relief Act of 1997, no net worth threshold was provided for trusts or estates.

Separate net worth threshold provided for estates and trusts.—An estate or trust that substantially prevails in litigation against the IRS may be awarded the costs it incurred in that litigation and related administrative proceedings provided that the net worth of the estate or trust is $2 million or less. Thus, the threshold for the award of costs to estates and trusts is the same as that provided for individuals. The net worth of trustees, executors, beneficiaries or heirs has no effect on the award of litigation costs.

The net worth of an estate is measured on the date of the decedent's death. The net worth of a trust is determined on the last day of the tax year involved in the proceeding.

Effective date. The estate and trust threshold applies to proceedings commenced after August 5, 1997.

Act Sec. 1453(a), adding Code Sec. 7430(c)(4)(D); Act Sec. 1453(b). Law at ¶ 5717. Committee Report at ¶ 12,965.

ELECTRONIC FUNDS TRANSFERS

Extension for Small Businesses

¶ 1040

Background

Code Sec. 6302(h), as added by section 523 of the North American Free Trade Agreement Implementation Act (P.L. 103-182), requires taxpayers with federal depository taxes in excess of certain specified thresholds to transfer the deposits electronically. In order to achieve the applicable percentage for 1997 of taxes subject to the Electronic Federal Tax Payment System (EFTPS), which was developed in response to the new requirements, all employers that deposited more than $50,000 of tax in 1995 were required to begin using EFTPS by January 1, 1997. However, section 1809 of the Small Business Job Protection Act of 1996 (P.L. 104-188) delayed that date for taxpayers not currently within the new system until July 1, 1997, and on June 2, 1997, the IRS, in IR-97-32, announced that it will not impose penalties through December 31, 1997, on businesses that make timely deposits using paper federal tax deposit coupons while converting to EFTPS.

Waiver of penalty on small businesses failing to make tax payments electronically.—Penalties under Code Sec. 6302(h) for failure to make federal tax deposits using the Electronic Federal Tax Payment System (EFTPS) will not be imposed for failures that occur before July 1, 1998, if the taxpayer was first required to use the electronic funds transfer system on or after July 1, 1997.

Effective date. The provision is effective on August 5, 1997.

Act Sec. 931. Law at ¶ 7014. Committee Report at ¶ 10,655.

DISCLOSURE OF RETURN INFORMATION

Department of Veterans Affairs

¶ 1043

Background

Code Sec. 6103 prohibits disclosure of tax returns and return information, except to the extent specifically authorized therein. The IRS is permitted to disclose self-employment tax information and certain other tax information to the Department of Veterans Affairs (DVA) for the purpose of assisting the DVA in determining eligibility for, and establishing correct benefit amounts under, certain of its needs-based pension, health care, and other payments. The DVA disclosure provision was scheduled to expire after September 30, 1998.

Provision allowing disclosure of certain tax information to the Department of Veterans Affairs extended.—Code Sec. 6103(l)(7)(D)(viii), which permits the IRS to disclose certain return information to the Department of Veterans Affairs (DVA), has been extended. The permitted disclosure to the DVA of self—employment tax information and certain other tax information supplied to the IRS was originally scheduled to expire September 30, 1998, but has been extended by the Taxpayer Relief Act of 1997 through September 30, 2003.

Effective date. The extension of this permitted disclosure provision is effective on August 5, 1997.

Act Sec. 1023(a), amending Code Sec. 6103(l)(7)(D)(viii); Act Sec. 1023(b). Law at ¶ 5613. Committee Report at ¶ 11,225.

Financial Management Service

¶ 1046

Background

Under prior law, the IRS was not permitted to disclose return information to the Treasury Department's Financial Management Service for the purpose of implementing levy provisions.

Disclosure to financial management service.—The IRS may disclose otherwise confidential return information to the Treasury Department's Financial Management Service in serving a notice of levy or release of levy with respect to any applicable government payment. The IRS may disclose return information, including taxpayer identity information, the amount of any unpaid liabilities (including penalties and interest) and the type of tax and tax period to which the unpaid liability relates.

The return information may be used by officers and employees of the Financial Management Service only for the purpose of, and to the extent necessary in, transferring levied funds in satisfaction of the levy, maintaining appropriate agency records in regard to such levy or the release thereof, notifying the taxpayer and the agency certifying such payment that the levy has been honored, or in the defense of any litigation ensuing from the honor of such levy.

The term applicable government payment means any federal payment (other than a payment for which eligibility is based on the income or assets, or both, of a payee) certified to the Financial Management Service for disbursement, and any other payment which is certified to the Financial Management Service for disbursement and which the IRS designates by published notice.

Effective date. These disclosure rules apply to levies issued after August 5, 1997.

Act Sec. 1026(a), adding Code Sec. 6103(k)(8); Act Sec. 1026(b), amending Code Sec. 6103(p) and Title 5, Sec. 552a of the U.S. Code; Act Sec. 1026(c). Law at ¶ 5613. Committee Report at ¶ 11,240.

D.C. Retirement Protection Act

¶ 1047

Background

Generally, returns and return information are confidential. Government officers and employees who have access to that information in connection with their government service are forbidden from disclosing the information contained in those returns unless they are specifically authorized by statute to do so. An exception to the anti-disclosure provisions was not provided with regard to return information necessary to verify whether an individual was eligible for benefits under the District of Columbia Retirement Act.

IRS disclosure of return information for purposes of the District of Columbia Retirement Protection Act.—Upon written request, the IRS must disclose return information necessary to determine an individual's eligibility and amount of benefits under the District of Columbia Retirement Protection Act. The IRS is required to furnish such information only if it is not available from the Social Security Administration. The request may seek information regarding wage income under Code Sec. 3121(a) or Code Sec. 3401(a); an individual's name, address, and taxpayer identification number; the identities of the payers of wage income; the taxpayer's identity; and the taxpayer's occupational status.

The request for information may be made by:

(1) a duly authorized officer or employee of the Department of Treasury;

(2) a trustee or designated officer or employee of a trustee as defined in the District of Columbia Retirement Protection Act of 1997; or

(3) any actuary engaged by a trustee, under the District of Columbia Retirement Protection Act of 1997, whose duties require the disclosure solely to determine an individual's eligibility for benefits, or the correct amount of the individual's benefits, under the District of Columbia Retirement Protection Act of 1997.

Background

Judicial or administrative proceedings. The same information may also be disclosed in a judicial or administrative proceeding in order to determine an individual's eligibility for, or the correct amount of, benefits under the District of Columbia Retirement Protection Act of 1997.

Effective date. The provision is effective on August 5, 1997.

Act Sec. 11024(b) of the Balanced Budget Act of 1997, adding new Code Sec. 6103(l)(16) and amending Code Sec. 6103(a)(3), (i)(7)(B)(i), (p)(3)(A) and (4) and Code Sec. 7213(a)(2). Law at ¶ 5613 and 5712.

Medicare Beneficiaries

¶ 1049

Background

Generally, returns and return information are confidential. Government officers and employees who have access to that information in connection with their government service are forbidden from disclosing the information contained in those returns unless they are specifically authorized by statute to do so. A specific authorization exists for a data-match program to identity Medicaid secondary payer situations. Under this program, Social Security Administration and IRS information is used to identify cases where a Medicare beneficiary (or the spouse) has employer-based health coverage. The authorization was scheduled to expire on October 1, 1998.

Medicaid secondary payer (MSP) data match program made permanent.—The exception from the prohibition on disclosure of return information for the Medicare secondary payer (MSP) data match program was made permanent by the Balanced Budget Act of 1997. This program utilizes social security administration data and Internal Revenue Service data to identify potential secondary insurance payers for purposes of the MSP program.

Effective date. This provision is effective on August 5, 1997.

Act Sec. 4631(c) of the Balanced Budget Act of 1997, striking Code Sec. 6103(l)(12)(F). Law at ¶ 5613. Committee Report at ¶ 20,045.

INFORMATION REPORTING

Sale of Residence

¶ 1050

Background

A real estate reporting person, as defined in Code Sec. 6045(e)(2), is required to report real estate transactions on Form 1099-S, "Proceeds from Real Estate Transactions." For sales and exchanges occurring on or before May 6, 1997, the reporting rules applied even where the gain from the sale of a principal residence was excluded under the Code Sec. 121 one-time exclusion of gain rule.

Reporting requirements for real estate closing information eased.—Sales of principal residences with a gross sales price of $250,000 or less ($500,000 or less in the case of married sellers) are excepted from the real estate transaction

reporting requirement of Code Sec. 6045(e), provided certain requirements are met. The effect of the provision is to except real estate transactions from reporting requirements where the gain from the sale or exchange is exempt from tax under Code Sec. 121, as amended by the Taxpayer Relief Act of 1997. See ¶ 129.

To be eligible for the exception, the person who would otherwise be required to file the information return must obtain certain written assurances from the seller of the real estate, in a form acceptable to the Secretary of the Treasury. The written assurances must provide that:

(1) the residence is the seller's principal residence, as defined by Code Sec. 121;

(2) no financing of the seller is federally subsidized indebtedness if the taxpayer is required to report such information for purposes of Code Sec. 121; and

(3) the full amount of gain on the sale or exchange is excludable from gross income under Code Sec. 121(a).

If written assurances are provided that the seller is married, the exception applies to a gross sales price of $500,000 or less.

The Secretary of the Treasury is authorized to increase the exception amount if it is determined that the increase would not materially reduce revenues.

Effective date. The provision applies to sales and exchanges after May 6, 1997. For special effective date rules, see ¶ 129.

Act Sec. 312(c), adding Code Sec. 6045(e)(5); Act Sec. 312(d)[e]. Law at ¶ 5599. Committee Report at ¶ 10,317.

Payment to Attorneys

¶ 1052

Background ___

Persons engaged in a trade or business, and making payments of attorney fees in the course of that trade or business, are generally required to report such fees. Under prior law, however, if the payment was a gross amount and it was not known what portion was the attorney's fee, no reporting was required on any portion of the payment.

Payments to attorneys subject to additional reporting requirements.— Any person engaged in a trade or business and making any payment to an attorney in the course of the taxpayer's trade or business in connection with legal services (whether or not such services are performed for the taxpayer) must file an information return with the IRS and a statement with the attorney with respect to such payment, even if the payment is a gross amount and it is not known what portion is the attorney's fee. The House Committee Report indicates that it is anticipated that this gross proceeds reporting would be required on Form 1099-B, which is currently used by brokers to report gross proceeds. The only exception to this new reporting requirement would be for payments that are to be reported on either Form 1099–MISC (or would be reported on Form 1099–MISC but for the "under $600" limitation) or on Form W-2.

Payments to corporations. The present exemption in Reg. § 1.6041-3(c) from reporting for payments made to corporations will not apply to payments made to

attorneys. According to the House Committee Report, reporting will be required under both Code Sec. 6041 and Code Sec. 6045 for payments to corporations that provide legal services. The House Committee Report also indicates that the exemption of Reg. § 1.6041-3(g) from reporting payments of salaries or profits paid or distributed by a partnership to the individual partners would continue to apply to both sections (since these amounts are required to be reported on Schedule K-1).

Reporting requirement details. The House Committee Report provides a number of supplementary details regarding the new reporting requirement. First, the provision applies to payments made to attorneys regardless of whether the attorney is the exclusive payee. Second, payments to law firms are payments to attorneys and, therefore, are subject to this reporting provision. Third, attorneys are required to promptly supply their taxpayer identification numbers (TINs) to persons required to file these information reports; failure to do so could result in the attorney being subject to penalty and the payments being subject to backup withholding. Fourth, it is indicated that the IRS should administer this provision so that there is no overlap between reporting under Code Sec. 6041 and reporting under Code Sec. 6045. For example, if two payments are simultaneously made to an attorney, one of which represents the attorney's fee and the second of which represents the settlement with the attorney's client, the first payment would be reported under Code Sec. 6041 and the second payment would not be reported under either Code Sec. 6041 or Code Sec. 6045, since it is known that the entire second payment represents the settlement with the client (and therefore no portion of it represents income to the attorney).

Effective date. These reporting requirements apply to payments made after December 31, 1997.

Act Sec. 1021(a), adding Code Sec. 6045(f); Act Sec. 1021(b)-(c). Law at ¶ 5599. Committee Report at ¶ 11,215.

Expanded Social Security Records for Tax Enforcement

¶ 1053

Background

The Secretary of Health and Human Services is not required to grant the Secretary of the Treasury access to the information collected in the federal case registry of child support orders. Furthermore, the Commissioner of Social Security is not required to share the information collected on applications for social security numbers for individuals who have not yet attained the age of 18 with the Secretary of the Treasury.

Enforcement efforts for tax benefits based on support or residence of children.—The Health and Human Services (HHS) Office of Child Support Enforcement is directed to collect information about the social security numbers of children at the time when it collects the information regarding the children's birth dates, beginning no later than October 1, 1999. The children's social security numbers are also to be included in the federal case registry of child support orders, beginning no later than October 1, 1999.

The Secretary of the Treasury is to have access to the information collected in the federal case registry of child support orders for the purpose of the administration of those Internal Revenue Code provisions that provide tax benefits based on the support or residence of children. The Secretary of the Treasury and the

Secretary of HHS are to consult with each other to resolve implementation issues. They are to report to Congress on the issues resolved during the consultation.

Required information on social security number applications. The Commissioner of Social Security is required to share with the Secretary of the Treasury that information collected on applications for social security numbers (SSNs) for individuals who have not yet attained the age of 18. The Secretary of the Treasury is entitled to such information for the purpose of the administration of those Internal Revenue Code provisions that provide tax benefits based on the support or residence of children.

Effective date. The provisions regarding expansion of coordinated enforcement efforts of the IRS and the HHS Office of Child Support Enforcement take effect on October 1, 1998. The provisions regarding submission of SSNs on applications apply to applications made after the date which is 180 days after August 5, 1997 and to information obtained on before, or after August 5, 1997.

Act Sec. 1090. Law at ¶ 7037. Committee Report at ¶ 11,560.

Payments Made by Federal Agencies

¶ 1055

Background

The head of each federal executive agency must file an information return indicating the name, address, and taxpayer identification number (TIN) of each person (including corporations) with which the agency enters into a contract, under Code Sec. 6050M. The Secretary of the Treasury has the authority to require that the returns be in such form and be made at such time as is necessary to make the returns useful as a source of information for collection purposes. The Treasury is given the authority both to establish minimum amounts for which no reporting is necessary as well as to extend the reporting requirements to federal license grantors and subcontractors of federal contracts. Under prior law, Reg. § 1.6050M-1(c)(1)(i) operated to provide that no reporting was required if the contract was for $25,000 or less.

Contract reporting requirements of executive federal agencies expanded.—The Code Sec. 6041A rules that require the filing of information returns regarding payments of remuneration of $600 or more for services apply to remuneration paid by a federal executive agency to a corporation, notwithstanding Reg. § 1.6050M-1(c)(1)(i), which provides a $25,000 reporting threshold. Contrary to the text of the Act, the House Committee Report indicates that this lower reporting requirement threshold also applies to remuneration paid to any other person. Also, the House Committee Report indicates that a copy of the reported information must be sent to the service provider. An exception to this reporting requirement is provided for services under certain classified or confidential contracts, and any other services that may be excepted under regulations issued after August 5, 1997.

Effective date. The lowering of the information reporting requirement threshold applies to returns, the due date for which (without regard to extensions), is more than 90 days after August 5, 1997 (November 3, 1997).

Act Sec. 1022(a), adding Code Sec. 6041A(d)(3); Act Sec. 1022(g). Law at ¶ 5597. Committee Report at ¶ 11,220.

Registration of Confidential Corporate Tax Shelters

¶ 1058

Background

Tax shelter registration. An organizer of a tax shelter is required to register the shelter with the IRS. If the principal organizer does not do so, this requirement may fall upon others. Under prior law, only those who participated in the organization of the shelter or persons who participated in its sale or management were subject to this requirement (Code Sec. 6111(b)). The shelter's identification number must be furnished to each investor who purchases or acquires an interest in the shelter. Failure to furnish this number to the tax shelter investors will subject the organizer to a $100 penalty for each such failure (Code Sec. 6707(b)). For this purpose a tax shelter is defined in Code Sec. 6111(c). A penalty may be imposed against an organizer who fails without reasonable cause to timely register the shelter or who provides false or incomplete information with respect to it (Code Sec. 6707(a)(1)).

Substantial understatements penalty. A 20-percent accuracy-related penalty applies to substantial understatements. In determining whether a substantial understatement exists, the amount of the understatement is reduced by any portion attributable to an item if (1) the treatment of the item on the return is or was supported by substantial authority or (2) facts relevant to the tax treatment of the item were adequately disclosed on the return or on a statement attached to the return and there is a reasonable basis for such treatment. However, with respect to tax shelter items of noncorporate taxpayers, the penalty may be avoided only if the taxpayer establishes that, in addition to having substantial authority for his position, he reasonably believed that the treatment claimed was more likely than not the proper treatment of the item. This reduction in the understatement is unavailable to corporations for their tax shelter items. The reduction in the understatement for items disclosed on the return is inapplicable to both corporate and noncorporate tax shelters. For this purpose, under prior law, a tax shelter was a partnership or other entity, plan, or arrangement the principal purpose of which is the avoidance or evasion of federal income tax.

Tax shelter registration requirements expanded and tax shelter penalties modified.—The definition of tax shelter is expanded for purposes of the registration and notification requirements to include "confidential corporate tax shelters." Under the new provision the person required to satisfy the registration requirements may in certain cases include individuals who discussed participation in such a shelter. The rules regarding the substantial underpayment penalty have been modified with respect to multi-party financing transactions and new penalties for the failure to register a confidential tax shelter have been enacted.

Tax shelter registration. An organizer of a "tax shelter" is required to register the shelter with the IRS and to furnish the shelter's identification number to each investor who purchases or acquires an interest in the shelter (Code Sec. 6111). The definition of a tax shelter for these purposes includes certain investments from which a person could reasonably infer from the offering for sale that certain ratios will be met, as well as certain other requirements (see Code Sec. 6111(c)). For these purposes, the new "confidential corporate tax shelters" provisions treat an offer to participate in a "confidential corporate tax shelter" as an offer for sale.

The definition of a "confidential corporate tax shelter" is any investment, plan, arrangement or transaction:

(1) that has as a significant purpose the tax avoidance or evasion by a corporate participant;

(2) that is offered to any potential participant under conditions of confidentiality; and

(3) for which the tax shelter promoters may receive total fees in excess of $100,000.

A transaction is offered under conditions of confidentiality if:

(1) an offeree (or any person acting on its behalf) has an understanding or agreement with or for the benefit of any promoter to restrict or limit the offeree's disclosure of the tax shelter or any significant tax features of the tax shelter; or

(2) the promoter claims, knows or has reason to know (or the promoter causes another person to claim or otherwise knows or has reason to know that a party other than the potential offeree claims) that the transaction (or one or more aspects of its structure) is proprietary to the promoter or any party other than the offeree, or is otherwise protected from disclosure or use.

The term "promoter" includes specified related parties within the meaning of Code Sec. 267 or Code Sec. 707 who participate in the organization, management or sale of the tax shelter.

A promoter of a corporate tax shelter is required to register the shelter with the IRS not later than day on which the tax shelter is first offered for sale to potential users. If the promoter is not a U.S. person, and if a required registration is not otherwise made, then each U.S. person who participated in discussions is required to register the shelter. An exception to this special rule provides that registration is not required if the U.S. person who participated in discussions notifies the promoter in writing not later than 90 days after discussions began that the U.S. person will not participate in the shelter and the U.S. person does not in fact participate in the shelter. For these purposes, an offer to participate in a "confidential corporate tax shelter" is treated as an offer for sale.

Penalties. The penalty for failing to timely register a "confidential corporate tax shelter" (see above discussion) is the greater of $10,000 or 50 percent of the fees paid to all promoters with respect to offerings prior to the date of late registration (this part of the penalty does not apply to fee payments with respect to offerings after late registration). The penalty is applicable to promoters and to actual participants in any corporate tax shelter who were required to register the tax shelter but did not. With respect to participants, however, the 50-percent penalty is based only on fees paid by that participant. Intentional disregard of the requirement to register by either a promoter or a participant increases the 50 percent penalty to 75 percent of the applicable fees.

Substantial understatement penalty. For purposes of the substantial understatement penalty, the amount of the understatement is reduced by any portion attributable to an item if the treatment of the item on the return is or was supported by substantial authority, or facts relevant to the tax treatment of the item were adequately disclosed on the return or on a statement attached to the return. However, this latter exception is applicable only if there was a reasonable basis for the tax treatment of the item. Under the new provisions, a corporation

does not have a reasonable basis for its tax treatment of an item attributable to a multi-party financing transaction if the treatment does not clearly reflect the income of the corporation.

Another modification to the substantial understatement penalty rules affects the special tax shelter rules. A tax shelter is now defined as an entity that has as a *significant* purpose (rather than as a principal purpose under prior law) the avoidance or evasion of Federal income tax.

Treasury report. The House Committee Report directs the Treasury Department, in consultation with the Department of Justice, to issue a report, due one year after August 5, 1997, on the following tax shelter issues:

(1) enforcement efforts with respect to corporate tax shelters and with respect to lawyers, accountants, and others who provide opinions regarding corporate tax shelters;

(2) an evaluation of the sufficiency of penalties; and

(3) an evaluation of whether confidential tax shelter registration should be extended to transactions in which the investor, or the potential investor, is not a corporation.

Effective date. The "confidential corporate tax shelter" registration provision applies to any tax shelter interests offered to potential participants after the date the IRS issues guidance with respect to the filing and other requirements described above. The modifications to the substantial understatement penalty apply to items with respect to transactions entered into after August 5, 1997.

Act Sec. 1028(a), redesignating Code Sec. 6111(d) and (e) as Code Sec. 6111(e) and (f), respectively, and adding a new Code Sec. 6111(d); Act Sec. 1028(b), adding Code Sec. 6707(a)(3); Act Sec. 1028(c), amending Code Sec. 6662(d)(2)(B) and (C)(iii); Act Sec. 1028(d), amending Code Sec. 6707(a)(1)(A) and (2); Act Sec. 1028(e). Law at ¶ 5615, 5697, and 5707. Committee Report at ¶ 11,250.

Purchasers of Fish

¶ 1061

Background

For payments made after December 31, 1997, a person who is engaged in the trade or business of purchasing fish for resale is required to file an information return reporting purchases of $600 or more during a calendar year from any person engaged in the trade or business of catching fish. Under Code Sec. 6050R(c)(1), as originally enacted by the Small Business Job Protection Act of 1996 (P.L. 104-188), each person whose name is required to be on the return must be furnished with a statement listing the name and address of the person filing the return, as well as the amount shown on the return. There was no requirement to include a telephone number.

Information returns relating to certain purchasers of fish.—Every person required to file an information return relating to the cash purchase of fish for resale must now furnish a statement to each person to whom reportable cash payments were made listing the telephone number of the information contact, in addition to a name and address and the amount shown on the return, as originally required under Code Sec. 6050R(c).

Effective date. The provision is effective for payments made after December 31, 1997.

Act Sec. 1601(a)(1), amending Code Sec. 6050R(c)(1). Law at ¶ 5609. Committee Report at ¶ 13,520.

Montana Demonstration Project

¶ 1064

Background

The long-standing practice of filing federal tax forms with the federal government and state tax forms with the state government results in duplicative reporting. Montana and the IRS have cooperatively developed a system to combine state and federal employment tax reporting onto one form.

Any unauthorized disclosure of a taxpayer's federal tax return information to state officials constituted a felony under Code Sec. 6103. The IRS's interpretation of Code Sec. 6103 hindered the project, because it considered the inclusion of the taxpayer's name, address, TIN, and signature on the combined form to constitute an unauthorized disclosure.

Combined federal and state employment tax reporting.—Montana taxpayers are to report state and federal employment tax information on one form under a demonstration project developed jointly by the IRS and the State of Montana. The five-year project is designed to test the feasibility and desirability of expanding combined federal and state tax reporting. The project is limited to employment tax reporting and to the disclosure of the taxpayer's name, address, TIN and signature. A taxpayer's signature and identity may be disclosed notwithstanding the confidentiality and disclosure requirements under Code Sec. 6103.

Effective date. This provision is effective on August 5, 1997.

Act Sec. 976(a); Act Sec. 976(b); Act Sec. 976(c), adding Code Sec. 6103(d)(5). Law at ¶ 5613. Committee Report at ¶ 10,925.

DISASTER AREAS

Deadline Extensions

¶ 1067

Background

The IRS is authorized under Code Sec. 6081 to grant a reasonable extension of time of up to six months (except in the case of taxpayers who are abroad) for the filing of returns, declarations, statements, and documents. However, the IRS cannot administratively extend certain deadlines set by law. Furthermore, although the IRS cannot extend the deadlines for employment tax returns or tax deposits, it has abated penalties for the late filing of employment tax returns and late deposits of taxes for employers in certain areas that have been declared disaster areas. However, interest must be charged from the original due date until the tax is paid.

Authority to postpone certain tax-related deadlines by reason of presidentially declared disaster.—The IRS may prescribe regulations to postpone

certain deadlines, for up to 90 days, for taxpayers affected by a presidentially declared disaster area. The deadlines that may be postponed are the same as those that may be postponed by reason of service in a combat zone. They include the deadlines for (1) the filing of any return of income, estate, or gift tax (except for employment or withholding taxes), (2) the payment of any income, estate, or gift tax (except employment or withholding taxes), (3) the filing of a Tax Court petition for redetermination of a deficiency or review of a Tax Court decision, (4) the allowance of a credit or refund, (5) the filing of a claim for credit or refund, (6) the bringing of any suit on such claim for credit or refund, (7) the assessment of any tax, (8) the giving or making of any notice or demand for payment of any tax or with respect to any liability to the IRS in respect of any tax, (9) the collection by levy or otherwise of any tax liability, (10) the bringing of a suit by the United States, or any officer on its behalf, with respect to any tax liability, and (11) any other act required or permitted under the related regulations. The period of the postponement may also be disregarded in determining the amount of any credit or refund.

A Presidentially-declared disaster is defined in Code Sec. 1033(h)(3) to mean any disaster which, with respect to the area in which the property is located, resulted in a subsequent determination by the President that the area warrants assistance by the Federal Government under the Disaster Relief and Emergency Assistance Act.

Interest on overpayments and underpayments. The postponement under this provision does not apply to the determination of interest on any overpayment or underpayment. However, see ¶ 1009 for a special provision which requires the IRS to abate the assessment of interest penalties in Presidentially-declared disaster areas if the time for filing an income tax return and paying income tax is extended.

Effective date. The provision applies with respect to any period for performing an act that did not expire before August 5, 1997.

Act Sec. 911(a), adding new Code Sec. 7508A; Act Sec. 911(b) and 911(c). Law at ¶ 5739. Committee Report at ¶ 10,585.

Disclosure of Audited Jurors

¶ 1070

Background

The disclosure of returns and return information may be authorized in connection with certain judicial and administrative tax proceedings. Under prior law, in a criminal or civil tax proceeding, the Secretary of the Treasury could have been required to disclose whether a prospective juror had been the subject of an audit or other tax investigation.

Repeal of authority to disclose juror information.—The Secretary of the Treasury is no longer authorized under Code Sec. 6103(h) to disclose whether a prospective juror in a criminal or civil tax proceeding has been subject to an audit or other tax investigation.

Effective date. The repeal of the provision applies to judicial proceedings commenced after August 5, 1997.

Act Sec. 1283(a), striking Code Sec. 6103(h)(5) and redesignating Code Sec. 6103(h)(6) as new Code Sec. 6103(h)(5); Act Sec. 1283(b), amending Code Sec. 6103(p)(4); Act Sec. 1283(c). Law at ¶ 5613. Committee Report at ¶ 12,545.

Chapter 11

Estimated Tax, Withholding, Employment Taxes

ESTIMATED TAX

Filing Threshold for Individuals

¶ 1101

Background

Under prior law, the amount of the *de minimis* threshold for an underpayment of estimated tax for individuals was $500.

Increase in *de minimis* threshold for underpayment of estimated tax.— The amount of the de minimis threshold for an underpayment of estimated tax for individuals has been increased from $500 to $1,000. Accordingly, additions to tax will not be imposed where the total tax liability for the year, reduced by any withheld tax and estimated tax payments, is less than $1,000.

Effective date. The provision is effective for tax years beginning after December 31, 1997.

Act Sec. 1202(a), amending Code Sec. 6654(e)(1); Act Sec. 1202(b). Law at ¶ 5693. Committee Report at ¶ 12,125.

Estimated Tax Safe Harbor for Individuals

¶ 1103

Background

There are several safe harbors under which individual taxpayers may avoid a penalty for failing to make required estimated tax payments. Under prior law, an individual who had adjusted gross income in excess of $150,000 for the preceding year could avoid the estimated tax penalty for the current year if the individual

Background

paid at least the lesser of 90 percent of the current year's tax, or 110 percent of the preceding year's tax.

Estimated tax safe harbor modified for individuals.—The safe harbor provision for individual taxpayers with adjusted gross income of more than $150,000 has been changed. Although these individuals may still avoid the estimated tax penalty by paying at least 90 percent of the current year's tax, the 110 percent safe harbor rule has been changed as follows:

(1) If the preceding tax year begins in 1998, 1999, or 2000, the new safe harbor percentage is *105 percent.*

(2) If the preceding tax year begins in 2001, the new safe harbor percentage is *112 percent.*

(3) If the preceding tax year is 2002 or thereafter, the safe harbor percentage is *110 percent.*

Example. Assume Jeff Brown has adjusted gross income of $160,000 in 2001. In order to use this safe harbor provision to avoid an estimated tax penalty for that year, he would have had to pay in at least the lesser of 90% of his 2001 liability or 105% of his tax liability for 2000 during 2001.

Planning Note. According to the legislative history of this provision, for tax years beginning in 1998, the safe harbor provision of 110 percent of the prior year's liability has been changed to "100 percent of the prior year's liability." In addition, no estimated tax penalty will be imposed under Code Sec. 6654 or Code Sec. 6655 for any period before January 1, 1998, for any payment the due date of which is before January 16, 1998, to the extent that an underpayment is created or increased by a provision of this new legislation.

Effective date. This provision applies with respect to any estimated tax installment payment due for tax years beginning after December 31, 1997.

Act Sec. 1091(b), amending Code Sec. 6654(d)(1)(C)(i); Act Sec. 1091(b). Law at ¶ 5693. Committee Report at ¶ 11,565.

Waiver of Estimated Tax Penalties Caused by Act

¶ 1105

Background

A penalty is imposed upon all taxpayers that fail to pay a certain percentage of their taxes, their estimated tax, on a quarterly basis. For both corporate and noncorporate taxpayers, the penalty is imposed regardless of whether there is reasonable cause for the underpayment. Because major tax legislation causes understandable difficulty in estimating tax for the initial periods following enactment, it has become routine for tax acts to contain provisions waiving penalties for failure to pay estimated tax for certain periods after the date of enactment.

Waiver of estimated tax penalties.—Taxpayers will not be liable for estimated tax penalties to the extent an underpayment was created or increased by any provision of the Act. This waiver applies only to underpayments attributable to periods before January 1, 1998, and for payments due before January 16, 1998.

Effective date. This provision is effective on August 5, 1997.

Act Sec. 1(d). Law at ¶ 7001. Committee Report at ¶ 10,110.

Large Corporate Underpayments

¶ 1108

Background

The large corporate underpayment interest rate generally applies to an underpayment that exceeds $100,000. The rate applies to periods beginning 30 days after the earliest of the date on which the first letter of proposed deficiency, a statutory notice of deficiency, or a nondeficiency letter or notice of assessment or proposed assessment is sent. Under prior law, the rate applied even if the first letter or notice of deficiency was for an amount of $100,000 or less.

Certain notices do not start interest at the large corporate underpayment rate.—The period to which interest applies at the large corporate underpayment rate does not begin with reference to the mailing of a letter or notice of deficiency, proposed deficiency, assessment or proposed assessment if the amount set forth is not greater than $100,000 (without regard to interest or penalties). Therefore, with respect to such a letter or notice, interest continues to accrue at the basic underpayment rate (the federal short-term rate plus three percentage points). The interest rate does not increase to the large corporate underpayment rate (the federal short-term rate plus five percentage points) until 30 days after the IRS issues a letter or notice showing an amount that exceeds $100,000.

Effective date. The provision is effective for purposes of determining interest for periods after December 31, 1997.

Act Sec. 1463(a), adding Code Sec. 6621(c)(2)(B)(iii); Act Sec. 1463(b). Law at ¶ 5689. Committee Report at ¶ 13,125.

PAYMENT OF TAX

Commercially Acceptable Means

¶ 1111

Background

Payment of taxes may be made by check or money order to the extent and under the conditions provided by the regulations issued under Code Sec. 6311. Prior to the Taxpayer Relief Act of 1997, no other means of payment was permitted.

Commercially acceptable means of paying taxes.—The IRS is authorized to accept payment of taxes by any commercially acceptable means that the Secretary deems appropriate (e.g., credit cards, debit cards, or charge cards) to the extent provided in Treasury regulations. These regulations will (1) specify which methods of payment will be acceptable, (2) determine when payment by such means will be considered received, (3) identify types of nontax matters related to payment by such means that are to be resolved by persons ultimately liable for payment and financial intermediaries, without the involvement of the Secretary, and (4) ensure that financial intermediaries will not be involved in resolution of tax matters.

Expanding the permissible means of paying taxes raises important issues. These include liability for tax payments, resolution of billing errors and other disputes, creditor status, and privacy protections.

Liability for tax payments. If a taxpayer pays taxes by means of a check, money order, or other means, such as by credit card, debit card, or charge card, and the amount paid is subsequently charged back to the Secretary, the taxpayer remains liable for payment and for all penalties and additions as if payment had not been tendered.

A different rule applies if payment is guaranteed by a financial institution. Such guarantees would arise if payment were made by means of a guaranteed draft (certified, treasurer's or cashier's check) or if a financial institution expressly guaranteed a credit card, charge card, or debit card payment. Under these circumstances, the United States will not only have a right to payment from the taxpayer, but will also have a lien upon the assets of the financial institution. In the case of a check or draft, the United States will have a lien upon all the assets of the financial institution on which it was drawn; in the case of a money order, upon all the assets of the issuer; and in the case of an express guarantee, upon all the assets of the institution making the guarantee. Moreover, the lien will have priority over all other claims against the financial institution, issuer, or guaranteeing institution except the costs of administration and the reimbursement of the United States for the amount spent in the redemption of the circulating notes of the financial institution.

Resolution of disputes. Billing errors and other disputes create potential conflicts between provisions in the Internal Revenue Code (Code) on the one hand and the Truth-in-Lending Act (TILA) and the Electronic Funds Transfer Act (EFTA) on the other. The Code provides mechanisms for the determination of tax liability, defenses, and other taxpayer protections and for the resolution of disputes with respect to those liabilities. TILA includes methods for determining credit card liabilities, defenses, and other consumer protections, and provisions for resolving disputes with respect to these liabilities.

If credit cards are accepted as a method for payment of taxes, neither section 161 of TILA (relating to correction of billing errors) nor any similar provision of state law will apply if the error alleged relates to the underlying tax liability. These provisions are applicable, however, if the error is a computational error or numerical transposition in the credit card transaction, or an issue as to whether the taxpayer authorized payment of the taxes by use of the credit card. A similar rule applies to debit card users with respect to section 908 of EFTA (relating to error resolution). Finally, payment of taxes is not subject to section 170 of TILA (relating to claims of cardholders against card issuers).

Prior to the Taxpayer Relief Act of 1997, the Code provided for refunds only to the person who made the overpayment (generally the taxpayer). Code Sec. 6311 provides, however, that if a taxpayer is entitled to a refund resulting from the correction of a billing error made under section 161 of TILA or section 908 of EFTA, the IRS is authorized to use the appropriate debit card or credit card system to credit the taxpayer's account.

Creditor status. Various responsibilities and obligations are imposed on creditors under the TILA. Under certain limited circumstances, the IRS could be included within the TILA's definition of "creditor." Code Sec. 6311, however, now explicitly provides that the IRS will not be treated as a creditor for purposes the TILA.

Privacy protections. If the IRS accepts credit card charges from taxpayers, it will have to disclose tax information to financial institutions in order to obtain payment and resolve billing disputes. This raises a concern about the sharing of tax information by financial institutions with private credit bureaus and direct mail marketers.

Code Sec. 6311 includes a general rule prohibiting any person from disclosing information relating to credit or debit card transactions obtained pursuant to Code Sec. 6103(k)(8) (see below), except for purposes directly related to the processing of such transactions, or the billing or collection of amounts charged or debited as a result of such transactions.

Exceptions are made to the general rule for information to be used for certain purposes. Debit or credit card issuers or others directly involved in the processing of credit card transactions, or the billing or collection of amounts debited or credited to such accounts may use and disclose information for purposes directly related to:

(1) statistical risk and profitability assessment;

(2) transferring receivables;

(3) auditing account information;

(4) complying with federal, state, or local law; or

(5) properly authorized civil, criminal, or regulatory investigation by federal, state, or local authorities.

In addition, debit or credit card issuers, or others acting on behalf of such issuers, may use such information for purposes directly related to servicing the issuer's accounts. Code Sec. 6103 warns, however, that use and disclosure of information pursuant to these rules may be made only to the extent authorized by written procedures promulgated by the IRS.

Disclosure authorization. The Secretary is given the authority to disclose returns or return information to financial institutions and others to the extent necessary for the administration of Code Sec. 6311. Disclosure of information for purposes other than to accept payment by check or money order may only be made to the extent authorized by written procedures authorized by the Secretary. In addition, Code Sec. 7431 (relating to civil damages for unauthorized disclosure of returns and return information) is amended to state that any reference to Code Sec. 6103 will be treated as including a reference to Code Sec. 6311 (confidentiality of information).

Authority of IRS to enter into contracts. The IRS is authorized to enter into contracts to obtain services related to receiving payment by other means if the cost is beneficial to the government. However, the IRS may not pay any fee or provide any other information under such contracts.

Effective date. The effective date is the date nine months after August 5, 1997 (May 5, 1998).

Act Sec. 1205(a), amending Code Sec. 6311; Act Sec. 1205(b); Act Sec. 1205(c), amending Code Secs. 6103(k) and 6103(p)(3)(A), and adding Code Sec. 7431(g); Act Sec. 1205(d). Law at ¶ 5613, 5661, and 5719. Committee Report at ¶ 12,140.

EMPLOYMENT TAX STATUS

Retail Securities Brokers

¶ 1114

Background

In determining whether a worker is an employee or independent contractor for employment tax purposes, the IRS may use the fact that instructions are provided by the business to the worker as an indication of employment status. One factor in determining the weight to be given the existence of instructions in reaching a conclusion as to whether a business has the right to control workers is whether the instructions are imposed only in compliance with governmental or governing body regulations. The IRS training manual indicates that if a business requires its workers to comply with rules established by a third party (such as municipal building codes, fire regulations, or the like) the fact that such rules are imposed should carry little weight in determining a worker's status. However, until the Taxpayer Relief Act of 1997, no specific rule existed concerning the weight to be given to instructions from broker-dealers to affiliated service representatives that are provided to the registered representatives merely to ensure compliance with state and federal investor protection laws.

Employment status of representatives of broker-dealers not determined by instructions provided by service recipients.—The Act provides that, for purposes of determining whether a registered representative of a securities broker-dealer is an employee for federal tax purposes, no weight is to be given to instructions from the service recipient that are given only in compliance with investor protection standards imposed by the federal government, any state government, or a governing body pursuant to a delegation by a federal or state agency. This monitoring performed by brokerage houses to ensure compliance with investor protection laws is not to be taken into account by the IRS in determining the employment status of registered representatives.

Effective date. This provision applies to services performed after December 31, 1997. However, the House Committee Report states that no inference is intended that the treatment under the provision is not present law.

Act Sec. 921(a); Act Sec. 921(b). Law at ¶ 7012. Committee Report at ¶ 10,635.

SELF-EMPLOYMENT TAX

Termination Payments to Insurance Salespersons

¶ 1117

Background

Taxes are imposed on an individual's net earnings from self-employment. Typically, net earnings are an individual's gross income from a trade or business minus any allowable deductions that are attributable to the business. Many insurance salespersons operate as independent contractors. As such, they must include payments received from an insurance company in net earnings from self-employment. However, a number of courts have determined that termination payments received by a salesperson were not includible in net earnings from self-

Background

employment. The rationale was that the termination payments were not "derived" from the salesperson's trade or business and, therefore, were not includible.

Termination payments of former insurance salespersons excludable.— Termination payments received by former insurance salespersons are excludable from net earnings from self employment under the new law if certain requirements are met. The exclusion for insurance salespersons who worked as independent contractors applies if (1) the amount is received after termination of the individual's agreement to perform services for the company, (2) the individual performs no services for the company after the termination and before the close of the tax year, (3) the payments are conditioned upon the salesperson agreeing not to compete with the company for at least one year following termination, and (4) the amount of the payment depends primarily on policies sold by or credited to the individual during the last year of the agreement and/or the extent to which the policies remain in force for some period after the termination, and does not depend on the length of service or overall earnings from services performed for the company. Eligibility for the payment may be based on length of service.

Planning Note. This exclusion codifies recent case law holding that the termination payments were not "derived" from the salesperson's trade or business and, therefore, were not includible in income (*W.R. Jackson,* 108 TC 130, CCH Dec. 51,965; *Milligan,* CA-9, 94-2 USTC ¶ 50,565, rev'g Dec. 48,632(M), TC Memo. 1992-655). Exclusion from income does not apply to termination payments in the form of deferred compensation. The delineated conditions for exclusion will be strictly applied when examining termination payments. Accordingly, the insurance salesperson and the insurance company must carefully craft their employment arrangement and structure payments to comply with this new exclusion.

Social Security Act change. The new law also amends the Social Security Act to provide that excludable termination payments are not treated as earnings for purposes of determining social security benefits.

Effective date. This provision is effective for payments after December 31, 1997.

Act Sec. 922(a), adding Code Sec. 1402(k); Act Sec. 922(b), adding Section 211(j) of the Social Security Act; Act Sec. 922(c). Law at ¶ 5403 and 7013. Committee Report at ¶ 10,640.

FUTA TAX

Surcharge Extension

¶ 1120

Background

Under the Federal Unemployment Tax Act (FUTA), a 6.2 percent gross tax rate is imposed on the first $7,000 paid annually by covered employers to each employee. Employers with no delinquent federal loans may credit 5.4 percentage points against the 6.2 percent rate on their state returns, making the minimum net federal unemployment tax rate 0.8 percent. In 1976, Congress added a temporary surtax of 0.2 percent of taxable wages to the permanent FUTA tax rate, giving the current 0.8 percent FUTA tax rate two components: (1) a permanent tax rate of

Background

0.6 percent and (2) a temporary surtax rate of 0.2 percent. Prior to the Taxpayer Relief Act of 1997, this surtax was scheduled to expire after 1998.

FUTA temporary surtax extended.—The Federal Unemployment Tax Act temporary surtax rate of 0.2 percent is extended through December 31, 2007.

Effective date. Effective on August 5, 1997.

Act Sec. 1035, amending Code Sec. 3301. Law at ¶ 5467. Committee Report at ¶ 11,315.

FUTA Exemption for Election Workers

¶ 1123

Background

The Federal Unemployment Tax Act (FUTA) requires that a state provide unemployment insurance coverage to most workers in state and local government jobs. Although there are certain exceptions to this broad requirement, there was no exception for individuals employed as election workers.

Election workers are exempted from FUTA coverage.—FUTA requires a state to cover under its unemployment compensation laws services performed in the employ of a state or local government, unless a specific exception has been provided. Election workers and election officials who receive less than $1,000 in a calendar year for services performed are excepted from FUTA and state UI coverage.

Effective date. This provision applies with respect to services performed after August 5, 1997.

Act Sec. 5405(a) of the Balanced Budget Act of 1997, amending Code Sec. 3309(b)(3)(D) and (E), and adding Code Sec. 3309(b)(3)(F); Act Sec. 5405(b) of the Balanced Budget Act of 1997. Law at ¶ 5468B. Committee Report at ¶ 20,055.

FUTA Exemption for Inmates

¶ 1126

Background

Federal law requires state unemployment programs to cover most state and local government jobs. An exception is provided for services for a government agency performed by inmates of custodial or penal institutions. However, no similar exception for inmates working in private sector jobs.

Wages earned by inmates excluded from FUTA.—The Act makes it clear that services provided by inmates in private-sector jobs are also exempted from state unemployment coverage.

Effective date. This provision applies to services performed after January 1, 1994.

Act Sec. 5406(a) of the Balanced Budget Act of 1997, amending Code Sec. 3306(c)(19) and (20), and adding Code Sec. 3306(c)(21); Act Sec. 5406(b) of the Balanced Budget Act of 1997. Law at ¶ 5468. Committee Report at ¶ 20,065.

FUTA Exemption for Religious Schools

¶ 1129

Background

Federal law requires states to provide unemployment insurance coverage for most jobs with nonprofit organizations in the same manner as private-sector jobs. However, an exception is permitted for jobs that are supervised or controlled by a church or association of churches. Prior to the Balanced Budget Act of 1997, this exception did not extend to employment in religious elementary or secondary schools.

Employment in a religious school exempted from FUTA coverage.—Unless a specific exception applies, jobs in nonprofit organizations are subject to the federal unemployment tax and must be covered by state unemployment insurance as are jobs in for-profit organizations. Services performed in the employ of either (1) a church (or association of churches) or (2) an organization that is operated primarily for religious purposes and that is operated, supervised, controlled, or principally supported by a church (or association of churches) are specifically exempted from this coverage.

The Balanced Budget Act of 1997 broadens this exception to include employment in a tax-exempt elementary or secondary school (described in Code Sec. 501(c)(3)), that is operated primarily for religious purposes without regard to whether the school is operated, controlled, supervised, or principally supported by a church (or association of churches). Thus, this exemption includes religious schools that are operated by lay boards.

Effective date. This provision applies with respect to service performed after August 5, 1997.

Act Sec. 5407(a) of the Balanced Budget Act of 1997, amending Code Sec. 3309(b)(1); Act Sec. 5407(b) of the Balanced Budget Act of 1997. Law at ¶ 5468B. Committee Report at ¶ 20,075.

WITHHOLDING

Federal Employees in Puerto Rico

¶ 1132

Background

The Treasury Secretary is authorized to enter into agreements providing for the withholding of state income taxes from the wages of federal employees in a state. Prior law defined a state as including a state, territory, or possession of the United States. In *P. Romero,* (CA-FC), 38 F.3d 1204, the Court of Appeals for the Federal Circuit invalidated an agreement with Puerto Rico because, as a commonwealth, Puerto Rico was not encompassed within the definition of a state.

Withholding of commonwealth income taxes from the wages of federal employees.—The new law expands the definition of a state for purposes of the Treasury Secretary's authority to enter into agreements providing for the withholding of state income taxes from the wages of federal employees in the state. States now include commonwealths in addition to territories, and possessions. Accordingly, the Treasury Secretary has the authority to enter into a withholding agreement with Puerto Rico.

This provision effectively overturns *P. Romero* (CA-FC, 38 F3d 1204).

Effective date. This provision is effective on January 1, 1998.

Act Sec. 1462(a), amending 5 U.S.C. section 5517(c); Act Sec. 1462(b). Law at ¶ 7045. Committee Report at ¶ 13,120.

Chapter 12

Excise Taxes

AIRPORT AND AIRWAY TRUST FUND TAXES

Extension and Modification

¶ 1201

Background

Fuel taxes. The taxes on aviation fuel, aviation gasoline, and noncommercial aviation were scheduled to terminate on September 30, 2007.

Air passenger tax. Prior law imposed taxes on persons and property using air transportation, and the taxes were scheduled to expire after September 30, 1997. Domestic air passenger transportation was subject to an excise tax equal to 10 percent of the amount paid for the transportation. The tax did not specifically apply to payments to airlines from credit card and other companies in exchange for the right to award frequent flyer or other reduced air travel rights.

International air passenger transportation was subject to a $6 departure excise tax imposed on passengers departing the United States, but no tax was imposed on passengers arriving in the United States from other countries.

Transportation between the 48 contiguous states and Alaska or Hawaii, or between Alaska and Hawaii, is treated as part domestic and part international. However, prior to amendment by the Taxpayer Relief Act of 1997 questions arose whether such a single international flight segment was subject to tax on both arrival and departure.

Under prior law, the air passenger ticket and freight excise taxes were collected from passengers and freight shippers by the commercial air carriers. Prior to amendment by the Taxpayer Relief Act of 1997, carriers were not secondarily liable.

Airport and Airway Trust Fund excise taxes extended and modified.—The Airport and Airway Trust Fund excise taxes are extended for 10 years, for theperiod from October 1, 1997, through September 30, 2007. The extended taxes include:

(1) the domestic and international air passenger excise taxes;

(2) the air cargo excise tax; and

(3) the noncommercial aviation fuels taxes.

The domestic commercial air passenger transportation tax rates are modified and other provisions are modified in several respects including subjecting payments for certain flight awards to the excise tax. The tax rate for international travel is also modified and now applies to both arrivals and departures, although special rules apply to Alaska and Hawaii. Flights beginning or ending at rural airports also have special rules. Certain of the new tax rates are inflation adjusted.

Fuel Taxes. The taxes on aviation fuel, aviation gasoline, and noncommercial aviation are extended from September 30, 1997, to September 30, 2007. The 4.3-cents-per-gallon excise tax on aviation gasoline and jet fuel will be deposited in the Airport and Airway Trust Fund, rather than in the General Fund, beginning with fuels sold or removed after September 30, 1997.

Domestic commercial air passenger transportation taxes modified. The domestic air passenger excise tax is changed to a tax equal to the total of nine percent of

the gross amount paid by the passenger for the transportation plus a $1 fixed amount per flight segment. The nine percent rate and the fixed dollar amount per flight segment are adjusted as follows:

Domestic Segments beginning	*Rate of passenger tax*	*Per flight segment charge*
After 9/30/97 and before 10/1/98	9%	$1.00
After 9/30/98 and before 10/1/99	8%	$2.00
After 9/30/99 and before 2000	7.5%	$2.25
During 2000	7.5%	$2.50
During 2001	7.5%	$2.75
During 2002	7.5%	$3.00

The passenger taxes are extended to September 30, 2007, and the flight segment charge is adjusted for inflation after 2002, (see below).

All transportation between points within the 48 contiguous states, and within Hawaii or Alaska, other than domestic segments associated with international transportation, is subject to tax at the 7.5-percent rate and the fixed segment charge. In the case of amounts paid outside the United States for taxable transportation, these taxes only apply to segments which begin and end in the United States.

The IRS is specifically authorized to disregard accounting allocations or other arrangements that have the effect of artificially reducing the base to which the 7.5-percent tax is applied. According to the Conference Committee Report, no inference is intended regarding treatment of these payments under prior law.

Flight segment. The term flight segment is defined as transportation involving a single takeoff and a single landing. For example, travel from New York to San Francisco, with an intermediate stop in Chicago, would, according to the Conference Committee Report, consist of two flight segments without regard as to whether the passenger changed aircraft in Chicago. There is no change in the number of flight segments for which a passenger is charged in the case of transportation routing changes initiated by the air carrier, provided there is no change in the fare charged. This rule would apply to flight changes for travel between the same origin and destination as a result of aircraft mechanical-problems, or to a diversion to another intermediate or destination airport because of bad weather conditions.

Example (1). On December 1, 1997, Lindy Berg purchases a $900 ticket to fly between Boston and Seattle with an intermediate stop in Chicago. She left the next day, but because of a snow storm in Chicago, the plane landed in Detroit. At no additional charge, Lindy takes a flight to Denver and then on to Seattle. Lindy incurs a tax of $83 ($2 (for two flight segments of $1 each) + $81 ($900 ticket × .09)). Lindy is not charged for the third flight because it was due to changes initiated by the air carrier, and there was no change in the fare charged.

Rural airports. The tax on flight segments is not applicable to a domestic segment beginning or ending at a rural airport. The tax on amounts paid for domestic transportation is applicable to flights to and from rural airports at a rate of 7.5 percent. Thus, the higher domestic rates for flights before October 1, 1999, are not applicable to a segment beginning or ending at a rural airport. For transportation with segments that do not begin or end at a rural airport (in addition to segments involving a rural airport), a mixed rate applies. The 7.5-percent rate applies to the portion of the amount paid for transportation that bears the same proportion as the miles in domestic segments that begin or end at rural airports bears to total miles in the transportation.

Example (2). On December 1, 1997, Rick Toven purchases transportation for $800 to fly from a rural airport in Snowville to Denver and then on to Houston. The total transportation is 1,200 miles, with 300 miles of the total involving the flight from the rural airport. Therefore, 25 percent of the transportation or $200 (300 miles ÷ 1200 total miles × $800) involves travel from a rural airport and is taxed at the 7.5-percent rate. The remaining 75 percent of the transportation, $600, is subject to the regular rate of 9 percent. Toven incurs a tax of $70 ($1 (for one taxable flight segment) + $15 ($200 × .075) + $54 ($600 × .09)). Toven does not incur a $1 flight segment tax for the segment from the rural airport to Denver.

A rural airport, for these purposes, is any airport that had fewer than 100,000 commercial passengers departing in the second preceding calendar year and

(1) is not within 75 miles of an airport that had at least 100,000 commercial passengers departing in the second preceding calendar year; or

(2) is receiving essential air service subsidies as of the date of enactment of this provision.

Thus, for 1998 an airport that had 90,000 commercial passengers in 1996 and was receiving essential air service subsidies on the date of enactment would qualify as a rural airport, even if it was 50 miles from an airport that had one million passengers in 1996.

Flight awards. Amounts paid to an air carrier (or any related person) for the right to award free or reduced rate air transportation are treated for purposes of the domestic air passenger excise tax as an amount paid for taxable transportation. Examples of such taxable amounts, according to the Conference Committee Report include:

(1) payments for frequent flyer miles purchased by credit card companies, telephone companies, rental car companies, television networks, restaurants and hotels, and other businesses for distribution to their customers and others; and

(2) amounts received by airlines pursuant to joint venture credit card or other marketing arrangements.

International travel facilities. A tax of $12 on any amount paid (whether within or without the United States) for any transportation of any person by air, if such transportation begins or ends in the United States. Thus, this tax is now applicable to all international arrivals and departures. However, this tax is not applicable to any transportation that is taxable in its entirety under the domestic air passenger excise tax rules.

Alaska and Hawaii. As under prior law, transportation between the 48 contiguous States and Alaska or Hawaii, or between Alaska and Hawaii, continue to be treated as part domestic and part international. However, the new amendments clarify that such a single international flight segment (between the 48 contiguous States and Alaska or Hawaii, or between Alaska and Hawaii) is due only on departure and at a reduced rate of $6. Thus only one $6 per passenger international tax is applicable despite the fact that the flight both departs into and arrives from international airspace. On a flight from Los Angeles to Hawaii in December, 1997, a passenger would be taxed at the nine-percent rate for the portion of the fare applicable to U.S. territorial miles, $1 per flight segment, and the $6 for the international segment rate.

Travel between Alaska or Hawaii and foreign countries, including U.S. possessions, is taxed exclusively as international travel and would be subject to the $12 tax.

Inflation adjustment. Beginning on January 1, 2003, and each January 1 thereafter, the fixed dollar amount per domestic flight segment will be indexed annually for inflation occurring after 2001, measured by changes in the Consumer Price Index rounded to the nearest 10 cents. The base year for the adjustment is 2001.

With regard to the tax on the use of international travel facilities, the $12 amount is indexed in the same manner beginning in 1999, with 1997 as the base year. The beginning of the domestic segment is treated as the taxable event. Similarly, the $6 rate applicable to Alaska and Hawaii is indexed beginning in 1999.

Secondary liability for tax. Although transportation providers are liable for collecting and remitting commercial air transportation taxes, liability for the tax is imposed on passengers. This is modified to impose secondary liability on air carriers providing the initial segment on transportation beginning or ending in the United States.

Effective dates. These provisions are generally effective on or after October 1, 1997, however, following are a number of exceptions:

(1) Ticket taxes. The provisions modifying ticket taxes are effective for transportation beginning on or after October 1, 1997. However, with regard to the tax on international travel, the new rates are generally applicable to amounts paid for tickets after October 1, 1997, unless the amounts were paid after August 12, 1997 for transportation beginning after September 30, 1997. The provision providing for the secondary liability of carriers for the international travel tax is also applicable to taxes due under these rules.

(2) Fuel taxes. The extension of the general aviation fuels excise taxes is effective on October 1, 1997.

(3) Mileage awards. Amendments impacting mileage awards generally apply to amounts paid after September 30, 1997. However, payments made after June 11, 1997, and before October 1, 1997, by one member of a controlled group for a right which is described in Code Sec. 4261(e)(3) and furnished by another member of the group after September 30, 1997, are treated as paid after September 30, 1997. For this purpose, all persons treated as a single employer under Code Sec. 52(a) or (b) are treated as members of a controlled group. Code Sec. 52(a) generally requires only 50-percent control to qualify as a consolidated group, and Code Sec. 52(b) contains special related-party rules for partnerships and proprietorships.

(4) Airport and Airway Trust Fund. The amendments increasing the deposits into the Airport and Airway Trust Fund apply with respect to taxes received in the Treasury on and after October 1, 1997.

(5) Delayed deposits of taxes. Regardless of the deposit requirements of Code Sec. 6302, the due date for deposits of commercial air passenger transportation taxes imposed by Code Sec. 4261 (which would otherwise be required to be made after August 14, 1997, and before October 1, 1997), is October 10, 1997. Similarly, the due date is October 5, 1998, for deposits with respect to (1) commercial air passenger transportation taxes imposed by Code Sec. 4261 (which would otherwise be required to be made after August 14,

1998, and before October 1, 1998) and (2) commercial air cargo and aviation fuels taxes under Code Secs. 4081(a)(2)(A)(ii), 4091 and 4271 (which would otherwise be required to be made after July 31, 1998, and before October 1, 1998).

Act Sec. 1031(a), amending Code Secs. 4041(c)(3)(B), 4081(d)(2)(B) and 4091(b)(3)(A)(ii); Act Sec. 1031(b), amending Code Secs. 4261(g)(1)(A)(ii) and 4271(d)(1)(A)(ii); Act Sec. 1031(c) (1) (2), amending Code Sec. 4261; Act Sec. 1031 (c)(3), amending Code Sec. 4263(c); Act Sec. 1031(d), amending Code Sec. 9502(b) and striking Code Sec. 9502(f); Act Sec. 1031(e); Act Sec. 1031(g). Law at ¶ 5473, 5479, 5485, 5503, 5505, 5507, and 5753. Committee Report at ¶ 11,275.

Emergency Medical Aircraft

¶ 1206

Background

The Small Business Job Protection Act of 1996 (P.L. 104-188) provided that fixed-wing aircraft that are equipped for and used exclusively to provide emergency medical services are exempt from the aviation excise taxes. The Act did not specify the basis for applying the exemption. A technical correction makes it clear that the exemption is to be applied on a flight-by-flight basis.

Aviation excise tax exemption.—The Small Business Job Protection Act of 1996 (P.L. 104-188) did not specify the basis for applying the emergency medical services exemption from the aviation excise taxes. A technical correction makes it clear that the exemption is to be applied on a flight-by-flight basis.

Effective date. The provision is effective as if included in the Small Business Job Protection Act (P.L. 104-188). As a result, the provision is effective as of August 27, 1996.

Act Sec. 1601(f)(4), amending Code Secs. 4041(a)(2), 4041(l), 4092(b), and 4261(g) and sections 1609(h)(1) and (4) of the Small Business Job Protection Act of 1996; Act Sec. 1601(j). Law at ¶ 5473, 5487, 5503, and 7076. Committee Report at ¶ 13,660.

DIESEL, GASOLINE, AND SPECIAL MOTOR FUELS

Fuel Used in Recreational Boats

¶ 1209

Background

Under prior law, diesel fuel used by recreational motorboats was subject to an excise tax of 24.3 cents per gallon. This tax was originally imposed in order to replace revenue lost when the excise tax on certain luxury boats was repealed. In 1996, the excise tax on diesel fuel used by recreational boats was temporarily suspended through December 31, 1997.

Repeal of excise tax on diesel fuel used in recreational motorboats.—The 24.3 cents-per-gallon diesel fuel tax imposed on diesel fuel used in recreational motorboats is repealed. The tax on diesel fuel used in diesel-powered trains is still subject to taxation.

Effective date. The repeal is effective on January 1, 1998.

Act Sec. 902(a), amending Code Sec. 6421(e)(2)(B); Act Sec. 902(b), amending Code Secs. 4041(a)(1) and 4083(a)(3); Act Sec. 902(c). Law at ¶ 5473, 5483, and 5669. Committee Report at ¶ 10,520.

Kerosene Taxed as Diesel Fuel

¶ 1211

Background

Under prior law, kerosene was not subject to excise tax unless it was blended with taxable diesel fuel or was sold for use as aviation fuel. When kerosene is blended with dyed diesel fuel to be used in a nontaxable use, the dye concentration of the fuel mixture must be adjusted to ensure that it meets IRS requirements for untaxed, dyed diesel fuel. Kerosene also is used in space heaters, and as with other heating oil uses, was not subject to excise tax. Another nontaxable use of kerosene includes feedstock use in the petrochemical industry.

Diesel fuel excise tax rules extended to kerosene.—The diesel fuel excise tax rules have generally been extended to kerosene. Thus, the diesel fuel tax rate of 24.3 cents per gallon for fuel used as a transportation motor fuel is extended to kerosene.

Kerosene is now taxed when it is removed from a registered terminal unless it is indelibly dyed and destined for a nontaxable use. Registration as a terminal facility eligible to handle non-tax-paid diesel fuel and kerosene is conditional on the facility offering its customers dyeing for nontaxable sales of diesel fuel and kerosene. Aviation-grade kerosene that is removed from the terminal by a registered producer of aviation fuel is not subject to the dyeing requirement if the person receiving the kerosene is registered under Code Sec. 4101 with respect to the tax imposed by Code Sec. 4091.

The IRS is authorized to issue regulations allowing tax-free sales of kerosene to wholesale distributors who satisfy registration requirements and who sell kerosene exclusively to retailers eligible for refunds with respect to undyed kerosene sold by them for a nontaxable use.

Feedstock kerosene that a registered industrial user receives by pipeline or vessel also is exempt from the dyeing requirement. Other feedstock kerosene would be exempt from the dyeing requirement to the extent and under conditions (including satisfaction of registration and certification requirements) prescribed by IRS regulations.

Refunds. Refund procedures are to be provided under which registered ultimate vendors may claim refunds of the tax paid on:

(1) kerosene sold from a pump which is not suitable for use in fueling any diesel-powered highway vehicle or train; or

(2) kerosene blended with heating oil to be used during periods of extreme or unseasonable cold.

The minimum amount for vendor refunds of tax paid on kerosene is $100.

Floor stock tax. A floor stock tax of 24.4 cents per gallon is imposed on kerosene held by any person on July 1, 1998. The floor stock tax must be paid on

orbefore August 31, 1998. Kerosene is held by a person for these purposes if title has passed to that person, whether or not delivery has been made.

The floor stock tax does *not* apply to kerosene:

(1) held by any person exclusively for any use to the extent a credit or refund of the Code Sec. 4081 tax is allowable for such use;

(2) held in the tank of a motor vehicle or motorboat;

(3) held on July 1, 1998, by "any person" if the aggregate amount of kerosene held by such person on that date does not exceed 2,000 gallons (amounts excluded in (1) and (2) are not counted in the 2,000 gallons) and proper information is submitted to the IRS. The term "any person" treats all members of a controlled group, as defined in Code Sec. 1563, as one person, but substitutes 50 percent for 80 percent. Similarly, nonincorporated persons under common control are treated as any person; or

(4) to the extent that the tax has been, or will be, imposed under Code Sec. 4081 or Code Sec. 4091.

All other provisions applicable to Code Sec. 4081 taxes, including penalties, that are not inconsistent with the above provisions, apply to the floor stock tax.

Effective date. This provision is effective on July 1, 1998. The floor stock tax is generally imposed on kerosene held by a person on July 1, 1998, see above for exceptions.

Act Sec. 1032(a), amending Code Sec. 4083(a); Act Sec. 1032(b), amending Code Sec. 4081(a)(2)(A)(iii); Act Sec. 1032(c), amending Code Secs. 4082 and 6427(l); Act Sec. 1032(d), adding new Code Sec. 4101(e); Act Sec. 1032(e), amending Code Secs. 4041(a)(2), 4041(c)(1), 4082, 4083(b), 4093(a), 6416(b)(2)(F), 6427(f), 6427(i)(3) and (4), 6715(c)(1), 7232, 9503(b)(1)(E), 9508(b)(2), and 9503(b)(5); Act Sec. 1032(f); Act Sec. 1032(g). Law at ¶ 5473, 5479, 5481, 5483, 5489, 5491, 5667, 5673, 5709, 5713, 5753, and 5757. Committee Report at ¶ 11,285.

Adjustment for Btu Equivalency

¶ 1216

Background

Currently, excise taxes are imposed on motor fuels of all kinds used in highway transportation. These taxes are deposited into the Highway Trust Fund to finance the federal highway system. Special motor fuels that contain fewer Btu's per gallon than gasoline include liquefied petroleum gas (propane), liquefied natural gas, methanol from natural gas, and compressed natural gas (CNG). Under prior law, gasoline and many special motor fuels were taxed at the same rate of 18.3 cents per gallon (CNG and methanol were taxed at reduced rates).

Before the Taxpayer Relief Act of 1997 was enacted, consumers who used one of the alternative fuels paid more federal excise taxes than those who used gasoline because it requires more gallons of the lower-energy-content fuel than gasoline to travel the same distance. Thus, the consumer using an alternative fuel paid disproportionately higher excise taxes into the Highway Trust Fund than those whose fuel of choice was gasoline.

Tax certain alternative fuels based on energy equivalency to gasoline.—The excise tax on certain alternative fuels is reduced to reflect the underlying intent that fuel should be taxed in proportion to its use on federal highways. These fuels have rates that are now lower than gasoline because it requires more of each of these fuels to go a mile than it does for gasoline.

In order to more accurately reflect the fuel equivalency to gasoline, the rate of tax for propane is reduced to 13.6 cents per gallon. The rates for liquefied natural gas and methanol from natural gas are also reduced to 11.9 and 9.15 cents per gallon, respectively. These reductions will be effective through September 30, 1999.

After September 30, 1999, these three fuels will be taxed according to their British thermal unit (Btu) equivalency to the 4.3 cents-per-gallon rate of gasoline. There is no change on the taxing of compressed natural gas.

Effective date. This provision is effective on October 1, 1997.

Act Sec. 907(a)(1), amending Code Sec. 4041(a)(2); Act Sec. 907(a)(2), amending Code Sec. 4041(d)(1); Act Sec. 907(b), amending Code Sec.4041(m)(1)(A); Act Sec. 907(c). Law at ¶ 5473. Committee Report at ¶ 10,545.

Gasoline Chain Retailers

¶ 1219

Background

Under the gasoline excise tax refund rules, a wholesale distributor may claim gasoline tax refunds on behalf of exempt customers, such as state and local governments, when gas is sold in bulk quantities. Prior to the Taxpayer Relief Act of 1997, retailers could not claim refunds on behalf of exempt customers.

Wholesale distributor defined.—For purposes of applying the gasoline excise tax refund rules, the definition of a wholesale distributor is expanded to include operators of multiple gasoline retail outlets. More specifically, a wholesale distributor includes any person who makes retail sales of gasoline at 10 or more retail motor fuel outlets.

Effective date. The provision applies to sales after August 5, 1997.

Act Sec. 905(a), amending Code Sec. 6416(a)(4)(B); Act Sec. 905(b). Law at ¶ 5667. Committee Report at ¶ 10,535.

Skydiving Transportation

¶ 1221

Background

A 10-percent excise tax is imposed on amounts paid for certain transportation of persons by air. There is also a fuels tax imposed on noncommercial aviation. According to the Senate Finance Committee Report for the Airport and Airway Revenue Act of 1970 (P.L. 91-258), an aircraft is subject to either the air transportation tax or the aviation fuels tax, but not to both, in regards to any one trip. Under Technical Advice Memorandum 9407001, a taxpayer's transportation of recreational skydivers for compensation to airborne drop points constituted the transportation of persons and was thus subject to the air transportation tax. However, the TAM noted that if the taxpayer used an aircraft in its skydiving

Background

training school, the transportation of persons would be incidental to the training and the flight would be subject to the fuels tax.

Exemption of skydiving flights from air transportation tax.—Any air transportation used exclusively for the purpose of skydiving is exempted from the air transportation excise taxes, regardless of whether skydiving instruction is offered to any of the passengers. As a result, skydiving flights are taxed as noncommercial aviation and are subject to the aviation fuels tax.

Effective date. The provision applies to amounts paid after September 30, 1997. The provision addressing the exemption for skydiving flights treated as noncommercial aviation takes effect October 1, 1997.

Act Sec. 1435(a), redesignating Code Sec. 4261(h) as Code Sec. 4261(i) and adding new Code Sec. 4261(h); Act Sec. 1435(b), amending Code Sec. 4041(d)(2); Act Sec. 1435(c). Law at ¶ 5473 and 5503. Committee Report at ¶ 12,870.

Highway Trust Fund

¶ 1223

Background

Currently, the Highway Trust Fund receives its revenues from taxes on 20 cents per gallon on highway diesel fuel and 14 cents per gallon on highway gasoline and special motor fuels. In addition, a tax of 4.3 cents-per-gallon applies to highway and other fuels. Before the Taxpayer Relief Act of 1997, the revenue from the 4.3 cents-per-gallon permanent excise tax was allocated to the General Fund.

Transfer of General Fund highway fuels tax revenues to the Highway Trust Fund.—The 4.3 cents-per-gallon excise tax from fuels is transferred to the Highway Trust Fund from the General Fund starting on October 1, 1997. In apportioning the money, 80 percent of the Highway Trust Fund allocation goes to the Highway Account, with the remaining 20 percent going to the Mass Transit Account.

Delayed deposit of highway motor fuel taxes. The deposit of excise taxes imposed upon gasoline, diesel fuel, and kerosene under Code Sec. 4081, and special motor fuels under Code Sec. 4041 that would otherwise be required to be made after July 31, 1998 and before October 1, 1998 has been postponed until October 5, 1998.

Effective date. This provision is effective for taxes received after September 30, 1997.

Act Sec. 901(a), amending Code Sec. 9503(b)(4); Act Sec. 901(b), amending Code Sec. 9503(e)(2); Act Sec. 901(c), adding Code Sec.9503(c)(7); Act Sec. 901(d), amending Code 9503(c) and (f); Act Sec. 901(e); Act Sec. 901(f). Law at ¶ 5755. Committee Report at ¶ 10,515.

AVIATION FUEL

Fixed-Base Operators

¶ 1227

Background

An excise tax is imposed on the sale of aviation fuel by any producer (defined to include a wholesale distributor) under Code Sec. 4091. Fuel sold at many rural airports is sold by retail dealers who do not qualify as wholesale distributors. This fuel is purchased by the retailers tax-paid. In certain instances, fuel that has been purchased tax-paid by a retailer will be resold to a producer. A producer that purchased fuel from a retail dealer in order to resell it to a customer incurred a second tax but was not able, under prior law, to receive a refund of the first tax so as to eliminate the double taxation.

Refund of prior excise tax paid by producers of fuel.—If a registered producer of aviation fuel establishes that a prior excise tax was paid, and not credited or refunded, on aviation fuel held by the producer, an amount equal to the tax paid will be refunded without interest to the producer in the same manner as if the amount were an overpayment of tax.

Effective date. The provision applies to fuel acquired by producers after September 30, 1997.

Act Sec. 1436(a), adding Code Sec. 4091(d); Act Sec. 1436(b), amending Code Sec. 6416(d); Act Sec. 1436(c). Law at ¶ 5405 and 5667. Committee Report at ¶ 12,875.

ALCOHOL FUELS

Effective Date Clarification

¶ 1230

Background

The expedited refund provision that applies to blenders of tax-paid gasoline and ethanol, which had expired for mixtures sold or used after September 30, 1995, was reinstated under the Small Business Job Protection Act of 1996 (P.L. 104-188) for the period beginning on the date of enactment (August 20, 1996) to mixtures sold or used before October 1, 1999. The refund provision did not apply from October 1, 1995, through August 19, 1996.

Ethanol blender refund period.—The expedited refund provision available to persons who blend tax-paid gasoline and ethanol, which was reinstated under the Small Business Job Protection Act (P.L. 104-188), is effective retroactive to the provision's expiration after September 30, 1995. Claims for refunds of tax paid during the period running from October 1, 1995, to August 20, 1996 (date of enactment of the Small Business Job Protection Act (P.L. 104-188)), must be filed before October 4, 1997.

Effective date. The provision is effective as if included in Subtitle G of the Small Business Job Protection Act of 1996. As a result, it is effective on January 1, 1994.

Act Sec. 1601(g)(1); Act Sec. 1601(j). Law at ¶ 5673. Committee Report at ¶ 13,675.

HEAVY TRUCKS

Nontaxable Repairs and Modifications

¶ 1233

Background

A 12-percent excise tax applies to the first retail sale of new or remanufactured heavy trucks, heavy trailers, and highway tractors. However, the Senate Finance Committee Report to the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647) stated that, for purposes of determining whether the manufacture of a new truck has occurred when repair or manufacture extends the useful life of a vehicle, a 75-percent ratio of repair costs to the full retail price of a comparable new truck is to be used as a safe harbor. Rev. Rul. 91-27 (1991-1 CB 192) provided guidance in applying the safe harbor.

Certain repairs and modifications not treated as manufacture.—Heavy trucks, heavy trailers, and highway tractors that are repaired or modified are not treated as manufactured or produced for purposes of the 12-percent retail excise tax if the cost of the repairs and modifications does not exceed 75 percent of the retail price of a comparable new vehicle.

Effective date. The provision is effective on January 1, 1998.

Act Sec. 1434(a), redesignating Code Sec. 4052(f) as Code Sec. 4052(e) and adding new Code Sec. 4052(f); Act Sec. 1434(c). Law at ¶ 5477. Committee Report at ¶ 12,860.

Certification for Resale

¶ 1236

Background

Under prior law, the 12-percent excise tax for the first retail sale of new or remanufactured heavy trucks, heavy trailers, and highway tractors did not apply to vehicles sold for resale or long-term leasing, provided that the purchaser satisfied certain registration requirements.

Replacement of registration requirement with certification requirement for certain sales of trucks, trailers, and tractors.—The registration requirement with respect to the resale or long-term leasing of heavy trucks, heavy trailers, and highway tractors has been replaced with a certification requirement. The IRS is authorized to issue regulations to permit vehicle purchasers to execute a statement, under penalties of perjury, on the sale invoice that the sale is for resale purposes.

Effective date. The provision is effective on January 1, 1998.

Act Sec. 1434(b)(1), amending Code Sec. 4052(d); Act Sec. 1434(b)(2), adding new Code Sec. 4052(g); Act Sec. 1434(c). Law at ¶ 5477. Committee Report at ¶ 12,860.

Treatment of Tires

¶ 1239

Background

Code Sec. 4071 imposes an excise tax on tires over 40 pounds based upon their weight. Code Sec. 4051 imposes a 12-percent retail excise tax on heavy trucks and trailers (including highway tractors) based upon the sales price of the heavy truck or trailer. Prior to the Taxpayer Relief Act of 1997, tires were taxed separately and their value was excluded from the sales price for purposes of computing the tax on heavy trucks and trailers. This factual determination of "value" caused many audit challenges.

Credit for tires on heavy trucks and trailers.—In order to simplify the computation of the 12-percent excise tax on heavy trucks and trailers (Code Sec. 4051), the value of tires on taxable trucks and trailers is now subject to the tax. However, a credit for the tire tax imposed by Code Sec. 4071 may be claimed. Previously, taxpayers excluded the value of the tires from the sale price of the truck or trailer on which the Code Sec. 4051 tax was imposed.

Effective date. The credit takes effect January 1, 1998.

Act Sec. 1402(a), amending Code Sec. 4051(e); Act Sec. 1402(b), amending Code Sec. 4052(b)(1)(B)(ii)-(iv); Act Sec. 1402(c). Law at ¶ 5475 and 5477. Committee Report at ¶ 12,725.

After-Market Alterations to Heavy Trucks

¶ 1241

Background

Under current law, an excise tax is imposed on the retail sale of heavy trucks and trailers. This tax specifically applies to sales of the truck trailer chassis and bodies. Certain trucks and trailers with a gross vehicle weight under the weight set forth in the Code are not subject to the tax. The tax is 12 percent of the sales price. The tax will no longer be imposed as of October 1, 1999.

The tax is also imposed on the purchase and installation of parts and accessories within six months after the original purchase. However, the tax does not apply to after-market installations that are deemed *de minimis.* Prior to the Taxpayer Relief Act of 1997, parts and accessories with an aggregate price that did not exceed $200 (including installation charges) were deemed *de minimis.*

Increase *de minimis* limit for after-market alterations.—An excise tax on the after-market installation of parts and accessories to vehicles classified as heavy trucks within six months after the vehicle's purchase will be imposed only if the aggregate price of the parts, accessories and installation costs during the period exceeds $1000. Previously, a $200 limit applied.

Effective date. This amendment applies to installations on vehicles sold after August 5, 1997.

Act Sec. 1401(a), amending Code Sec. 4051(b)(2)(B); Act Sec. 1401(b). Law at ¶ 5475. Committee Report at ¶ 12,715.

LUXURY CARS

Phaseout of Luxury Tax on Automobiles

¶ 1242

Background

An excise tax is imposed on the sale of automobiles whose price exceeds a designated amount of $36,000 in 1997. For 1997, the tax is eight percent of the excess of the sale price over the designated amount, but will decline by one percentage point per year until reaching three percent in 2002. The tax will expire on December 31, 2002.

The tax applies to the first retail sale after manufacture, production, or importation of an automobile, but not to subsequent sales. Under Code Sec. 4003, however, a 10-percent tax is imposed on the separate purchase of a vehicle and "parts and accessories therefore" if the sum of the separate purchases exceeds the designated amount. The rate of tax on separate purchases is not determined by reference to the rate of tax on the purchase of luxury automobiles. Under prior law, it was not clear whether the phaseout reduction and expiration date applied to separate purchases of the vehicle and parts as well as to new luxury automobiles.

Phaseout of luxury tax clarified.— For 1997, the luxury car tax imposed by Code Sec. 4001 is eight percent of the excess of the sale price over a $36,000 (for 1997) threshold, but will decline by one percentage point per year until reaching three percent in 2002. The tax will expire on December 31, 2002.

Code Sec. 4003 imposes a 10-percent tax on the separate purchase of a vehicle and parts and accessories therefore if the sum of the separate purchases exceeds the designated amount. Prior to the Taxpayer Relief Act of 1997, it was not clear that the phaseout reduction and expiration date for the luxury car tax on new automobiles described above was also applicable to the separate purchase of a vehicle and parts and accessories. A technical amendment clarifies that the phaseout reduction and expiration date is to apply to both.

Effective date. The amendment is effective for sales after August 5, 1997.

Act Sec. 1601(f)(3)(A), amending Code Sec. 4001(f); Act Sec. 1601(f)(3)(B), amending Code Sec. 4001(g); Act Sec. 1601(f)(3)(C). Law at ¶ 5469. Committee Report at ¶ 13,655.

After-Market Alterations to Luxury Cars

¶ 1245

Background

Under present law, an excise tax is imposed on the retail sale of luxury cars. The tax is eight percent of the amount by which the sale price exceeds an inflation-adjusted base of $36,000 in 1997. This tax is being phased out at a rate of one

Background

percent per year through the year 2002, after which time the tax will no longer be imposed.

The tax is also imposed on any purchase and installation of parts and accessories within six months after the original purchase.

However, the tax does not apply to after-market installations of parts and accessories that are deemed *de minimis*. Prior to the Taxpayer Relief Act of 1997, installation of parts and accessories with an aggregate price that did not exceed $200 (including installation charges) were deemed *de minimis*.

Increase *de minimis* limit for after-market alterations.—An excise tax on after-market installation of parts and accessories to a luxury car within six months after the vehicle's purchase will be imposed only if the aggregate price of the parts, accessories and installation charges during the period exceeds $1,000. Previously, a $200 limitation applied. The change was made by Congress to reduce the number of excise tax return filers, many of whom were required to report a very small amount of tax.

Effective date. The amendment applies to installations on vehicles sold after August 5, 1997.

Act Sec. 1401(a), amending Code Sec. 4003(a)(3)(C); Act Sec. 1401(b). Law at ¶ 5471. Committee Report at ¶ 12,715.

Electric and Clean-Fuel Vehicles

¶ 1247

Background

The luxury tax on automobiles is imposed on the first retail sale after manufacture, production, or importation of the automobile. The excise tax is imposed on the excess of the sales price over a threshold amount, adjusted for inflation. For 1997, the tax rate is eight percent and the threshold amount, as adjusted for inflation, is $36,000. The tax rate will be reduced to three percent by the year 2002 and will expire after December 31, 2002. Prior to the Taxpayer Relief Act of 1997, the same threshold amount, as adjusted for inflation, applied to all vehicles.

Exemption from luxury automobile classification.—The luxury tax on automobiles is imposed on the first retail sale after manufacture, production, or importation of the automobile. The excise tax is imposed on the excess of the sales price over a threshold amount above which the excise tax applies. The threshold, or "applicable amount," is $30,000, which is adjusted for inflation ($36,000 for 1997), for vehicles other than certain clean-burning fuel vehicles and electric vehicles. Under the new law, in the case of certain clean-burning vehicles and electric vehicles, the threshold of $30,000, as adjusted for inflation, is modified to exempt from the excise tax the cost of producing an automobile with environmental benefits.

Modification for clean-fuel vehicles. If the taxpayer purchases a passenger vehicle to which qualified clean-fuel vehicle property, as defined by Code Sec. 179A(c)(1)(A), has been installed, the threshold amount takes into account the value of the components installed. The applicable amount is $30,000, as adjusted

for inflation, plus the increase in the price of the vehicle, as determined under Code Sec. 4002, due to the installation of the qualified clean-fuel vehicle property.

> **Example.** On October 1, 1997, Joe Clean purchases a passenger automobile for $43,000 to which retrofit parts and components have been added to make the vehicle a clean-burning vehicle. If Clean had purchased the automobile without having certain components replaced to make it a clean-burning vehicle, the cost of the automobile would have been $39,000. The 1997 threshold amount of $36,000 is increased to $40,000 to reflect the $4,000 value of the components. Clean must pay an excise tax of $240 or eight percent on $3,000, which is the excess of the $43,000 sales price over the $40,000 modified threshold.

Modification for electric vehicles. If a taxpayer purchases a vehicle produced by an original equipment manufacturer that is designed to be propelled primarily by electricity ("purpose built passenger vehicle"), the applicable amount is 150 percent of $30,000, as adjusted for inflation.

Effective date. The provisions apply to sales and installations occurring after August 5, 1997.

Act Sec. 906(a), amending Code Sec. 4001(a); Act Sec. 906(b)(1), amending Code Sec. 4001(e); Act Sec. 906(b)(2), amending Code Sec. 4001(f); Act Sec. 906(b)(3), amending Code Sec. 4003(a)(1)(A); Act Sec. 906(b)(4), amending Code Sec. 4003(a)(2)(B); Act Sec. 906(c). Law at ¶ 5469 and 5471. Committee Report at ¶ 10,540.

ENVIRONMENTAL TAXES

Imported Recycled Halon-1211

¶ 1248

Background

Under current law, an excise tax is imposed on the manufacturer or importer for the sale or use of ozone-depleting chemicals. However, current law provides a tax exemption for otherwise taxable chemicals that are recovered and recycled within the United States. Prior to the Taxpayer Relief Act of 1997, imported recycled halon-1211 was also tax-exempt when obtained from countries that are signatories to the Montreal Protocol on Substances That Deplete the Ozone Layer.

Excise tax on imported recycled halon-1211.—Imported recycled halon-1211 is no longer exempt from the excise tax on ozone-depleting chemicals. According to the Conference Committee Report, a non-ozone depleting substitute for halon-1211 is being developed. Thus, allowing importers of recycled halon-1211 to benefit from the current excise tax exemption could destroy the attempt to produce non-ozone depleting chemicals.

Effective date. The provision is effective on August 5, 1997.

Act Sec. 903(a), amending Code Sec. 4682(d)(1); Act Sec. 903(b). Law at ¶ 5519. Committee Report at ¶ 10,525.

Leaking Underground Storage Tanks

¶ 1251

Background

In order to fund cleanup costs associated with leaking underground storage tanks, an excise tax of 0.01 cents per gallon was imposed on gasoline, diesel fuel, special motor fuels, aviation fuels, and fuels used on inland waterways. This tax expired after December 31, 1995.

Reinstatement of LUST Trust Fund taxes.—The Leaking Underground Storage Tank Trust Fund tax of 0.01 cents per gallon is reinstated for the period beginning after September 30, 1997, and before April 1, 2005. The tax is imposedon the sale of gasoline, diesel fuel (included fuel used in trains), special motor fuels (other than liquefied petroleum gas), aviation fuels, and inland waterways fuels.

Effective date. The provision takes effect on August 5, 1997.

Act Sec. 1033, amending Code Sec. 4081(d)(3). Law at ¶ 5479. Committee Report at ¶ 11,290.

COMMUNICATIONS TAX

Pre-paid Telephone Cards

¶ 1253

Background

A three-percent excise tax is imposed on amounts paid for local and long-distance telephone services. Generally, the company providing the telephone service collects the tax from consumers and pays it over to the IRS. Prior to the Taxpayer Relief Act of 1997, the application of the communications tax to long-distance pre-paid telephone cards was uncertain.

Pre-paid phone cards subject to communications tax.—The bill clarifies that the three percent excise tax imposed on long-distance telephone service applies to amounts paid by third parties to communication service providers for pre-paid telephone cards. As a result, prepaid telephone cards offered by service stations, convenience stores, and other companies not in business of telecommunications that offer phone cards to their customers will be subject to the tax. A prepaid telephone card is any card or other arrangement that entitles a holder to obtain communications services and pay for the services in advance.

For purposes of the tax, the face amount of a prepaid card is treated as the amount paid for communications services. This amount is treated as paid when the card is transferred by any telecommunications carrier to any person who is not a carrier.

Value of service offered. In the case of any prepaid telephone card where a user is entitled to other than a specific dollar amount, such as a "unit card" or a "minute card," the face amount is to be determined under regulations issued by the IRS. The Conference Committee Report indicates that the tax applicable to such cards be based on the retail value of the telephone service offered to the consumer. The Conference Committee Report notes that the Federal Communica-

tions Commission generally requires telecommunications carriers to file a tariff listing the prices of their various service offerings including the price of units or minutes offered via prepaid telephone cards. In this case, the excise tax will apply to the number of units or minutes multiplied by the tariffed price of the units or minutes at the time the prepaid telephone card is sold by a telecommunications carrier to a person who is not a telecommunications carrier. Although the Conference Committee Report acknowledges that this tariffed value may not in all cases correspond to the over-the-counter price that the final customer may pay to the card, the tariffed price is the best way to achieve neutral treatment of "dollar cards" and "unit" or "minute cards." The Conference Report indicates that, if a prepaid card does not have an underlying tariff, tarrifs for comparable services should be applied.

The Conference Committee Report states that in the case where a communications service provider requires certain customers to prepay for their services as assurance that payment is made by the customer for services to be provided, these provisions will not apply if the customer is entitled to a full cash refund for the value of any unused service. These payments are to be considered deposits.

Effective date. The provision applies to amounts paid in calendar months beginning more than 60 days after August 5, 1997 (October 5, 1997).

Act Sec. 1034(a), adding Code Sec. 4251(d); Act Sec. 1034(b). Law at ¶ 5501. Committee Report at ¶ 11,295.

TAX ON VACCINES

Uniform Tax Rate Structure

¶ 1255

Background

A manufacturer's excise tax is imposed on the sale of certain commonly prescribed vaccines in order to provide funding for the Vaccine Injury Compensation Trust Fund. Prior to the Taxpayer Relief Act of 1997, diphtheria, pertussis, and tetanus (DPT) was taxed at a rate of $4.56 per dose; diphtheria and tetanus (DT) was taxed at $.06 per dose; measles, mumps, and rubella (MMR) was taxed at $4.44 per dose; and polio vaccine was taxed at $0.29 per dose. Generally, if the vaccine fell within more than one of the above-listed categories, the amount of tax imposed was the sum of the tax imposed for each listed vaccine.

Simplification of vaccine tax.—In order to simplify the vaccine tax, a new single tax rate of $0.75 per dose is imposed on any listed vaccine component. Vaccines containing more than one component are taxed at a rate of $0.75 multiplied by the number of components. Thus, for example, the DPT (diphtheria, pertussis and tetanus) is taxed at a rate of $2.25 ($3 \times 0.75$) per dose.

In addition, three new vaccines are added to the list of taxable vaccines as a result of the Centers for Disease Control's recommendation that these vaccines be widely administered to children in the U.S. The new taxable vaccines include HIB (haemophilus influenza type B), Hepatitis B, and any vaccine against chicken pox. These newly listed vaccines are also subject to the 0.75 per dose excise tax.

Effective date. The new rate structure goes into effect for vaccine sales beginning after August 5, 1997. According to the Conference Committee Report, no floor stocks tax is to be collected, or floor stock refunds permitted, for vaccines held

on the effective date. For purposes of determining a claim for a refund or credit filed before January 1, 1999, relating to vaccines that were destroyed or returned to the manufacturer after August 5, 1997, the credit or refund shall is on $0.75 per dose tax rate.

Act Sec. 904(a), amending Code Sec. 4131(b); Act Sec. 904(b), amending Code Sec. 4132(a)(1); Act Sec. 904(c), amending Code Sec. 4132(a)(2)-(8); Act Sec. 903(d) and (e). Law at ¶ 5493 and 5495. Committee Reports at ¶ 10,530.

CIGARETTE TAX

Rate Increases

¶ 1257

Background

Excise taxes imposed on tobacco products include a $12 per thousand tax on small cigarettes ($25.20 per thousand large cigarettes); a $1.125 per thousand tax on small cigars (up to $30 per 1,000 large cigars); a $0.0075 per 50 papers tax on cigarette papers; a $0.15 per 50 tubes tax on cigarette tubes; a $0.12 per pound tax on chewing tobacco; a $0.36 per pound tax on snuff; and a $0.675 per pound tax on pipe tobacco. Prior to the Taxpayer Relief Act of 1997, there was no excise tax imposed on tobacco that could be sold to consumers for making cigarettes.

Excise tax on tobacco products increased.—The Act increases the excise taxes imposed on tobacco products as follows: a $19.50 per thousand tax on small cigarettes ($17 per thousand on cigarettes removed during 2000 or 2001); a $40.95 per thousand tax on large cigarettes ($35.70 per thousand on cigarettes removed during 2000 or 2001); a $1.828 per thousand tax on small cigars ($1.594 per thousand on cigars removed during 2000 or 2001); a tax equal to 20.719 percent of the price sold on large cigars (18.063 percent on cigars removed during 2000 or 2001) but not more than $48.75 per thousand ($42.50 per thousand on cigars removed during 2000 or 2001); a 1.22 cents per 50 papers tax on cigarette papers (1.06 cents on cigarette papers removed during 2000 or 2001); a 2.44 cents per 50 tubes tax on cigarette tubes (2.13 cents on cigarette tubes removed during 2000 or 2001); a 19.5 cents per pound tax on chewing tobacco (17 cents on chewing tobacco removed during 2000 or 2001); a 58.5 cents per pound tax on snuff (51 cents onsnuff removed during 2000 or 2001); and a $1.0969 per pound tax on pipe tobacco (95.67 cents on pipe tobacco removed during 2000 or 2001).

Excise tax added for roll-your-own-tobacco. In addition to the increase in the excise tax rate for existing categories of tobacco products, the excise tax is extended to roll-your-own tobacco. Roll-your-own tobacco is tobacco that, due to its appearance, type, packaging or labeling, is suitable and likely to be offered to, or purchased by, consumers for making cigarettes. The tax imposed on roll-your-own-tobacco, manufactured in, or imported into the United States is $1.0969 per pound (95.67 cents on roll-your-own tobacco removed during 2000 or 2001). A proportionate tax is imposed at the applicable rate on all fractional parts of a pound.

Credit against tobacco industry settlement agreement. An amount equal to the increase in excise taxes for cigarettes, smokeless tobacco and roll-your-own tobacco will be credited against total settlement payments made by parties under future federal legislation implementing the proposed tobacco industry settlement agreement of June 20, 1997.

Compliance provisions for tobacco products headed for export. The exemption from the tobacco tax that applies to exported tobacco products and cigarette papers and tubes will apply only to articles marketed for export. The products or papers must be marked, labeled or bear notices, in accordance with regulations prescribed by Secretary of the Treasury.

Civil penalty for exported products. Civil penalties are imposed to persons who sell, reland, or receive within U.S. jurisdiction tobacco products or cigarette papers or tubes that are labeled or shipped for exportation. The civil penalty also applies to persons who sell or receive relanded tobacco products or cigarette papers and tubes, and persons who aid or abet in the selling, relanding or receiving of such products, papers and tubes. The penalty is imposed unless the exemption from the tobacco tax for exported products papers and tubes applies under Code Sec. 5704.

The penalty imposed is equal to the greater of $1,000 or five times the amount of the tax otherwise imposed. All products and papers relanded within U.S. jurisdiction, as well as all vessels, vehicles, and aircraft used in the relanding (or in removing the products, papers, and tubes from the place of relanding) are forfeited to the United States. The penalty is in addition to other penalties under Title 26.

Civil penalties also apply if restrictions imposed on the importation of previously exported tobacco products are violated. Tobacco products and cigarette papers and tubes that were previously exported from the United States may only be imported or brought into the United States as provided for in Code Sec. 5704(d). References to exportation in Code Sec. 5704(d), Code Sec. 5761 and other provisions that the Secretary of the Treasury provides for in regulations include a reference to shipment to the Commonwealth of Puerto Rico.

Miscellaneous provisions. The Act provides the following miscellaneous provisions affecting the tobacco excise tax:

(1) Importers as well as manufacturers are generally required to be qualified in order to engage in the tobacco products business (i.e., obtain a permit, etc.).

(2) The tax on cigarette papers under Code Sec. 5701(c) applies regardless of the number of papers in the book.

(3) The term "internal revenue bond", as used in the definition of removal under Code Sec. 5701(c), refers to internal revenue bond under Code Sec. 5704(c).

(4) The Secretary of the Treasury may reject a permit to commence business as a manufacturer or importer of tobacco products or as an export warehouse proprietor if minimum manufacturing activity requirements, as prescribed by the Secretary of the Treasury, are not carried out on the business premises.

Effective date. The provisions apply to articles removed after December 31, 1999. For this purpose, the term "removed," is defined under Code Sec. 5702(k), as amended by the Balanced Budget Act of 1997. The provision coordinating the increase in tobacco excise taxes with the proposed tobacco industry settlement agreement is effective immediately after the applicable excise tax increases become effective.

Special transitional rule for certain manufacturers and importers. A special transitional rule applies to persons that are engaged in business as a manufacturer of roll-your-own tobacco or as an importer of tobacco products or cigarette papers

or tubes on August 5, 1997. If an application to engage in business under subchapter B of Chapter 52 is submitted before January 1, 2000, the applicants may continue to engage in business pending final action on the application. All provisions of Chapter 52 apply to the applicant as if the applicant were a holder of a permit under Chapter 52 to engage in business.

Act Sec. 9302(a)-(f) of the Balanced Budget Act of 1997, amending Code Sec. 5701(a)-(f); Act Sec. 9302(g)(1) of the Balanced Budget Act of 1997, redesignating Code Sec. 5701(g) as Code Sec. 5701(h) and adding new Code Sec. 5701(g); Act Sec. 9302(g)(2) of the Balanced Budget Act of 1997, adding Code Sec. 5702(p); Act Sec. 9302(g)(3)(A) and (B) of the Balanced Budget Act of 1997, amending Code Sec. 5702(c) and (d); Act Sec. 9302(h)(1) of the Balanced Budget Act of 1997, amending Code Sec. 5704(b), redesignating Code Sec. 5761(c) and (d) as Code Sec. 5761(d) and (e), respectively, and adding new Code Sec. 5761(c), amending Code Sec. 5761(a) and Code Sec. 5761(d), as redesignated, and adding Code Sec. 5754; Act Sec. 9302(h)(2) of the Balanced Budget Act of 1997, amending Code Secs. 5712, 5713, 5721, 5722, 5762, and 5763; Act Sec. 9302(h)(3) of the Balanced Budget Act of 1997, amending Code Sec. 5701(c); Act Sec. 9302(h)(4) of the Balanced Budget Act of 1997, amending Code Sec. 5702(k); Act Sec. 9302(h)(5) of the Balanced Budget Act of 1997, redesignating Code Sec. 5712(2) as (3) and adding new Code Sec. 5712(2); Act Sec. 9302(i) of the Balanced Budget Act of 1997; Act Sec. 1604(f)(3) of the Taxpayer Relief Act of 1997, adding Act Sec. 9302(k); Act Sec. 1604(f)(4) of the Taxpayer Relief Act of 1997. Law at ¶ 5572, 5572A, 5572B, 5572C, 5572D, 5572E, 5572F, 5572G, 5572H, 5572I, and 5572J. Committee Report at ¶ 13,955 and 20,085.

Floor Stocks Taxes

¶ 1258

Floor stocks taxes imposed.—Floor stocks taxes are imposed in connection with the increase in the excise tax rate for tobacco products and cigarette papers and tubes manufactured in or imported into the United States (see ¶ 1257). Products, papers and tubes that are removed before tax increase date and held forsale, will be taxed in an amount that is the difference between the tax determined under the old tax rate and the tax determined under the new tax rate. The tax increase date means January 1, 2000, and January 1, 2002. A credit of $500 is allowed against the amount of floor stocks taxes imposed. The credit may not exceed the amount of floor stocks taxes on any tax increase date.

The person holding cigarettes on any tax increase date is liable for the tax. The tax is to be paid on or before April 1 following any tax increase date, in a manner prescribed by the Secretary of the Treasury.

The Secretary of the Treasury has the authority to provide for an exemption from floor stocks taxes in the case of cigarettes held in vending machines.

Act Sec. 9302(j) of the Balanced Budget Act of 1997. Law at ¶ 5572. Committee Report at ¶ 20,085.

ARROWS

Component Parts of Arrows

¶ 1270

Background

Under prior law, an excise tax of 11 percent of the selling price of a completed arrow was imposed on the sale by the manufacturer, producer, or importer of an arrow that was 18 inches or more in length or was suitable for use with a taxable bow.

Excise tax on component parts of certain arrows.—An excise tax of 12.4 percent of the selling price of a completed arrow is imposed on the sale of the four component parts of an arrow (i.e., shaft, point, nock and vane) by the manufacturer, producer, or importer. The tax applies to the component parts used in the manufacture of an arrow that, after its assembly, is 18 inches or more in length or is suitable for use with a taxable bow (i.e., bows having a draw weight of 10 pounds or more).

Effective date. The provision is effective for arrow components sold after September 30, 1997.

Act Sec. 1433(a), amending Code Sec. 4161(b); Act Sec. 1433(b). Law at ¶ 5497. Committee Report at ¶ 12,855.

DISTILLED SPIRITS

Returns to Distilled Spirits Plant

¶ 1271

Background

When domestic distilled spirits are returned to bonded premises, the excise taxes that had been paid are credited or refunded. However, the tax imposed on imported bottled spirits when they were withdrawn from customs custody was not credited or refunded when the spirits were returned to bonded premises.

Credit or refund for imported spirits available.—In order to alleviate the disparity in the treatment of domestic and imported spirits, refunds or credits of excise taxes on imported distilled spirits are now available for distilled spirits that are returned to distilled spirits plants.

Effective date. The provision takes effect on the first day of the first calendar quarter that begins at least 180 days after August 5, 1997 (April 1, 1998).

Act Sec. 1411(a), amending Code Sec. 5008(c)(1); Act Sec. 1411(b). Law at ¶ 5541. Committee Report at ¶ 12,755.

Export Bonds

¶ 1272

Background

A bond is required of an exporter who withdraws distilled spirits from a bonded warehouse for export or transportation to a customs bonded warehouse

Background

without payment of excise tax. The bond could be canceled "on the *submission* of such evidence, records, and certification indicating exportation" as the IRS may have prescribed by regulations.

Requirements for certification of export bonds relaxed.—Bonds that are required by an exporter to withdraw distilled spirits from warehouses without payment of excise tax may now be canceled if there is proof of exportation, rather than upon submission of evidence of the spirit's exportation. The IRS may issue regulations stipulating such proof.

Effective date. The provision takes effect on the first day of the first calendar quarter that begins at least 180 days after August 5, 1997 (April 1, 1998).

Act Sec. 1412(a), amending Code Sec. 5175(c); Act Sec. 1412(b). Law at ¶ 5555. Committee Report at ¶ 12,760.

Maintenance of Records on Premises

¶ 1273

Background

Under prior law, records and reports relating to the production, storage, denaturation, and processing activities of distilled spirits were required to be kept on the premises where the operations covered by the records and reports were carried on.

Records may be kept off the premises.—Records and reports that are required of proprietors of distilled spirits plants may be maintained at locations other than on the plant premises.

Effective date. The provision is effective on the first day of the first calendar quarter that begins at least 180 days after August 5, 1997 (April 1, 1998).

Act Sec. 1413(a), amending Code Sec. 5207(c); Act Sec. 1413(b). Law at ¶ 5557. Committee Report at ¶ 12,765.

Fermented Material

¶ 1274

Background

Prior to the enactment of the Taxpayer Relief Act of 1997, a distilled spirits plant could only receive beer, which would be used in the production of spirits, if the beer was produced on contiguous brewery premises.

Transfers from a brewery may be received at a distilled spirits plant.—Beer may now be brought from any brewery for use in production of spirits. In addition, the beer is exempt from excise tax. This will alleviate disparities in the treatment of different types of alcoholic beverages in connection with federal excise taxes.

Effective date. The provision takes effect on the first day of the first calendar quarter that begins at least 180 days after August 5, 1997 (April 1, 1998).

Act Sec. 1414(a), amending Code Sec. 5222(b)(2); Act Sec. 1414(b), adding Code Sec. 5053(f) and redesignating former Code Sec. 5053(f) as Code Sec. 5053(i); Act Sec. 1414(c)(1), adding Code Sec. 5056(c) and redesignating former Code Sec. 5056(c) as Code Sec. 5056(d); Act Sec. 1414(c)(2), amending Code Sec. 5056(d); Act Sec. 1414(d). Law at ¶ 5547, 5551, and 5559. Committee Report at ¶ 12,770.

Wholesale Dealers and Sign Requirement

¶ 1275

Background

A wholesale liquor dealer was required to post a sign that identified the business place as a wholesale liquor establishment. Failure to post the sign would subject the dealer to a penalty.

Requirement to post sign repealed.—Wholesale liquor dealers are no longer required to post a sign identifying their businesses as such. Thus, the penalty for failure to post a sign is no longer applicable.

Effective date. The rules relating to required sign posting by wholesalers are effective on August 5, 1997.

Act Sec. 1415(a), repealing Code Sec. 5115; Act Sec. 1415(b)(1), amending Code Sec. 5681(a); Act Sec. 1415(b)(2), amending Code Sec. 5681(c); Act Sec. 1415(c). Law at ¶ 5553 and 5571. Committee Report at ¶ 12,775.

Hard Cider

¶ 1276

Background

Alcoholic beverages are currently subject to an excise tax, which differs depending upon how the product is classified. Wine is taxed at a rate of $1.07 per gallon, unless the winery is permitted to claim a credit against the tax of 90 cents per gallon on the first 100,000 gallons produced annually. Under prior law, hard cider, which is apple cider containing alcohol, was taxed as if it were wine.

Rate of alcohol excise tax reduced on certain hard ciders.—The excise tax rate is reduced from $1.07 to 22.6 cents per gallon for apple cider that has an alcohol content not in excess of seven percent. This reduction comports to the belief that cider is in more direct competition with beer as opposed to wine. Although cider is now taxed similarly to beer, the classification of cider is not changed, however, and is still considered wine.

There is no reduction in the amount of tax imposed on those parties who produce less than 100,000 gallons of cider a year. These producers are still allowed the existing credit permitted for small wineries, but at the rate of 5.6 cents per gallon instead of the existing 90 cents per gallon permitted for wine. Thus, the effective after credit tax rate on small producers will remain at 17 cents per gallon (22.6 cents minus 5.6 cents). Production of cider is still taken into account and

aggregated with other beverages when determining whether a producer qualifies for a tax credit for small producers.

Effective date. This provision is effective on October 1, 1997.

Act Sec. 908(a), adding Code Sec. 5041(b)(6); Act Sec. 908(b), amending Code Sec. 5041(c)(1); Act. Sec. 908(c). Law at ¶ 5543. Committee Report at ¶ 10,550.

Collection Point Study

¶ 1277

Background

Currently, an excise tax of $13.50 per proof gallon is levied on distilled spirits. The timing of this tax depends on whether or not the spirits are bottled domestically. The tax is imposed for both domestically produced spirits and those produced abroad and imported to the United States for domestic bottling at the time the beverages leave the distillery. This tax is imposed regardless of when the ultimate sale occurs, if at all. Bottled spirits imported into the United States are taxed when they are removed from the first customs bonded warehouse in which they were kept upon delivery to the United States.

Alcohol that is derived from fruit is allowed a tax credit which effectively reduces the tax liability at the time of payment, which would differ depending on where the spirits were bottled.

Study feasibility of moving collection point for distilled spirits excise tax.—The point in the production, distribution and purchase cycle at which the distilled spirits excise tax is imposed is being studied by the Treasury Department. Specifically, the option of imposing the tax at the time when the spirits are removed from the registered wholesale warehouse is to be considered, giving special attention to administrative issues such as effects on tax compliance by the taxpayer.

The study is also to determine the number of taxpayers who will be affected by any future change in the timing of this tax collection, as well as any changes in financial responsibilities required. Additionally, the issues concerning separation of nontax-paid distilled spirits from those eligible for the tax and Treasury Department budgetary and staffing capabilities need to be explored.

Effective date. This study is to be completed and transmitted to the Committee on Finance and the Committee on Ways and Means no later than March 31, 1998.

Act Sec. 909. Law at ¶ 7007. Committee Report at ¶ 10,555.

WINE

Wine Returned to Bond

¶ 1280

Background

A credit or refund of the excise tax on domestic wine was available only if the wine returned to bond was unmerchantable. Further, the returned wine must then be treated as wine in bond on the premises of a bonded wine seller.

Credit or refund available for merchantable wine.—A credit or refund is now available for all domestic wine returned to bond, whether or not the wine is unmerchantable.

Effective date. The provision is effective on the first day of the first calendar quarter that begins at least 180 days after August 5, 1997 (April 1, 1998).

Act Sec. 1416(a), amending Code Sec. 5044(a); Act Sec. 1416(b), amending Code Secs. 5044 and 5361; Act Sec. 1416(c). Law at ¶ 5545 and 5561. Committee Report at ¶ 12,780.

Sugar Content

¶ 1281

Background

Only wines made exclusively from loganberries, currants, or gooseberries may use up to 60 percent (by volume) sugar to correct natural deficiencies. Other wines are generally subject to a 35-percent limitation. Wines made with sugar in excess of the applicable limitation must be labeled "substandard."

Sugar limits increased on certain wines.—In order to correct high acid content in certain wines, up to 60 percent (by volume) sugar may be used in any wine made from juice, such as cranberry or plum juice. The juice must have an acid content of 20 or more parts per thousand before any correction of the fruit or berry.

Effective date. The above provision takes effect on the first day of the first calendar quarter that begins 180 days after August 5, 1997 (April 1, 1998).

Act Sec. 1417(a), amending Code Sec. 5384(b)(2)(D); Act Sec. 1417(b). Law at ¶ 5565. Committee Report at ¶ 12,785.

Wine Imported in Bulk

¶ 1282

Background

Imported wine that was removed from customs custody was subject to tax upon its removal.

Transfer of wine imported in bulk.—Wine that is imported in bulk may be withdrawn from customs custody and transferred to a bonded wine cellar without payment of tax on the wine. The winery that receives the wine is liable for the tax imposed on the withdrawn wine from customs custody, and the wine importer is relieved of the tax liability.

Effective date. The above provision takes effect on the first day of the first calendar quarter that begins at least 180 days after August 5, 1997 (April 1, 1998).

Act Sec. 1422(a), adding Code Sec. 5418; Act Sec. 1422(c). Law at ¶ 5563. Committee Report at ¶ 12,825.

Wine Labels

¶ 1283

Background

Before the Taxpayer Relief Act of 1997, there were regulations providing that certain semi-generic terms such as "Chablis" or "Burgundy" could be used on wine labels to reflect geographic origin. However, any deviations from industry standards and accepted norms dealing with either the source of the grapes or the process used to make the wine had to be clearly indicated on the label.

Also, under prior law, the Secretary of the Treasury had the discretion to eliminate currently listed semi-generic names.

Codify treasury department regulations regulating wine labels.—The regulations permitting the use of certain terms are codified in an attempt to clarify the current status of the law concerning the labelling of wine. These terms, which reflect the geographic origin and the process by which the wine is produced, are allowed provided that any deviation from industry norms for the term is clearly marked on the label.

> **Example.** Some of the terms that are included in the definition of a semi-generic term include: Angelica, Burgundy, Claret, Chablis, Chianti, Malaga, Marsala, Madiera, Moselle, Port, Rhine Wine or Hock, Sauterne, Haut Sauterne, and Tokay.

Effective date. This provision is effective on August 5, 1997.

Act Sec. 910(a), adding Code Sec. 5388(c); Act Sec. 910(b). Law at ¶ 5567. Committee Report at ¶ 10,560.

BEER

Withdrawal for Destruction

¶ 1285

Background

Exemption from excise tax, for beer withdrawn from a brewery, was only allowed when beer was removed for export, when unfit for beverage use, for laboratory analysis, for research, development or testing, for personal or family use of the brewer, or as supplies for certain vessels and aircraft.

Beer withdrawn for destruction.—Beer that is removed from a brewery for destruction is exempted from tax, subject to Treasury regulations.

Effective date. The exemption takes effect on the first day of the first calendar quarter that begins at least 180 days after August 5, 1997 (April 1, 1998).

Act Sec. 1419(a), adding Code Sec. 5053(h); Act Sec. 1419(b). Law at ¶ 5547. Committee Report at ¶ 12,795.

Use at Embassies

¶ 1286

Background

Under prior law, an exemption from excise tax only applied to imported beer, withdrawn from customs bonded warehouses, used for the family and official use of representatives of foreign governments or public international organizations.

Exemption available for beer withdrawn for embassy use.—Domestically produced beer, as well as imported beer, may now be withdrawn from a custom bonded warehouse free of excise tax. In addition, beer may be withdrawn from a brewery, without payment of the excise tax, for transfer to any customs bonded warehouse. The beer must be consumed in the United States by, and used for the family or official use of, representatives of foreign countries or public international organizations.

Effective date. The provision is effective on the first day of the first calendar quarter that begins at least 180 days after August 5, 1997 (April 1, 1998).

Act Sec. 1418(a), adding Code Sec. 5053(g); Act Sec. 1418(b). Law at ¶ 5547. Committee Report at ¶ 12,790.

Drawback on Exported Beer

¶ 1287

Background

A domestic producer of beer for export was allowed a drawback on the tax paid on the beer on the "submission of such evidence, records and certificates indicating exportation" as required by regulations.

Drawback on exported beer without records.—A domestic producer of exported beer may recover the tax ("drawback") paid on the beer if there is proof of exportation, as the IRS may require by regulations. This is a relaxation of the certification requirement to recover the tax.

Effective date. The above provision is effective on the first day of the first calendar quarter that begins at least 180 days after August 5, 1997 (April 1, 1998).

Act Sec. 1420(a), amending Code Sec. 5055; Act Sec. 1420(b). Law at ¶ 5549. Committee Report at ¶ 12,815.

Imports Transferred to Brewery

¶ 1288

Background

Imported beer that was removed from customs custody was subject to tax upon its removal.

Transfer of beer imported in bulk.—Beer that is imported in bulk may be withdrawn from customs custody and transferred to a brewery without payment of tax on the beer. The brewer that receives the beer is liable for the tax imposed on the withdrawn beer from customs custody, and the beer importer is relieved of the tax liability.

Effective date. The provision is effective on the first day of the first calendar quarter that begins at least 180 days after August 5, 1997 (April 1, 1998).

Act Sec. 1421(a), adding Code Sec. 5418; Act Sec. 1421(c). Law at ¶ 5569. Committee Report at ¶ 12,820.

OTHER EXCISE TAX

Registration Requirements for Tax-Free Sales

¶ 1290

Background

Manufacturers and retailers ordinarily must pay excise tax on sales. Certain sales are exempt from these excise taxes if the seller, the purchaser, and any second purchaser are registered with the IRS. Prior to the Taxpayer Relief Act of 1997, the IRS could waive the registration requirement for the purchaser and second purchaser only in certain cases.

Authority for IRS to grant exemptions from excise tax registration requirements.—The IRS may now issue regulations waiving in all instances the requirement that purchasers and second purchasers register in order for a sale described in Code Sec. 4221 to be exempt from excise taxes imposed on manufacturers and retailers. The new rule does not change the present-law requirement that sellers register.

Effective date. This provision is effective on August 5, 1997.

Act Sec. 1431(a), amending Code Sec. 4222(b)(2); Act Sec. 1431(b). Law at ¶ 5499. Committee Report at ¶ 12,845.

Repeal of Deadwood

¶ 1291

Background

Under prior law, the Code had provisions giving temporary reductions for the tax on piggyback trailers if they were sold before July 18, 1985, and for the removal of hard minerals from a deep seabed before June 28, 1990. These provisions have been repealed as they are out of date and unneeded.

In addition, an excise tax is imposed on the sale or use of ozone-depleting chemicals on the manufacturer and the importer of the chemicals. In 1996, the base tax amount was $5.80 per pound. It will be increased by 45 cents every year after 1995.

Repeal of excess deadwood provisions.—The following provisions are removed from the Internal Revenue Code as they are no longer relevant and are "deadwood":

> Code Sec. 4051(d) (relating to temporary reductions in tax for piggy-back trailers sold before July 18, 1985);
>
> Subchapter F of chapter 36 (relating to the taxation of hard mineral removal from deep seabeds before June 28, 1990).

Code Sec. 4681(b)(1)(B) is amended to eliminate references to tax rates applicable to ozone-depleting chemicals sold or used before 1996.

Code Sec. 4682(g) is amended to eliminate references to expired provisions relating to the taxation of the treatment of methyl chloroform, halons, and chemicals used in rigid foam insulation.

Effective date. This provision is effective on August 5, 1997.

Act Sec. 1432(a), amending Code Sec. 4051; Act Sec. 1432(b), repealing Code Secs. 4495, 4496, 4497, and 4498; Act Sec. 1432(c), repealing Code Sec. 4681(b)(1)(B) and (C), adding new Code Sec. 4681(b)(1)(B), and amendingCode Sec. 4682(g). Law at ¶ 5475, 5509, 5511, 5513, 5515, 5517, and 5519. Committee Report at ¶ 12,850.

¶ 1292

Background

The Small Business Job Protection Act of 1996 (P.L. 104-188) repealed a provision allowing purchasers of diesel-powered automobiles and light trucks to claim an advance refund on the amount of diesel fuel tax they would be expected to pay over the life of the vehicle. However, several highway trust fund provisions relating to the diesel fuel tax credit were inadvertently left in the Internal Revenue Code.

Advance refunds of diesel fuel tax.—The Small Business Job Protection Act of 1996 (P.L. 104-188) repealed Code Sec. 6427(g), which allowed purchasers of diesel-powered automobiles and light trucks to claim an advance refund on the amount of diesel fuel tax they would be expected to pay over the life of the vehicle. However, several highway trust fund provisions relating to the diesel fuel tax credit were inadvertently left in the Internal Revenue Code. These provisions, in Code Sec. 9503(c)(2)(A) and (e)(5) have been stricken.

Effective date. The provision is effective for vehicles purchased after August 20, 1997.

Act Sec. 1601(f)(2), amending Code Sec. 9503(c)(2)(A) and (e)(5)(A); Act Sec. 1601(j). Law at ¶ 5755. Committee Report at ¶ 13,650.

MISCELLANEOUS ACT PROVISIONS

Tax Proration Not Required

¶ 1294

Background

Code Sec. 15 provides rules for determining the amount of tax due when a rate change takes effect on other than the first day of a taxpayer's tax year. In such case, all taxpayers must follow the statutory procedure for tax proration outlined in Code Sec. 15. The proration rules of Code Sec. 15 apply unless the law that makes the rate change specifically provides that the rate change is not to be considered a change in rate for Code Sec. 15 purposes.

Tax proration under Code Sec. 15 not required.—The Act specifically provides no amendments made by the Act are to be treated as a change of tax rate for purposes of Code Sec. 15. Thus, taxpayers will not have to prorate their income tax liability should the Act's amendments operate to change their rate of tax during the tax year.

Effective date. This provision is effective on August 5, 1997.

Act Sec. 1(c). Law at ¶ 7001.

CODE SECTIONS ADDED, AMENDED OR REPEALED BY THE TAXPAYER RELIEF ACT OF 1997, THE BALANCED BUDGET ACT OF 1997, AND THE TAXPAYER BROWSING PROTECTION ACT OF 1997.

The law as amended by the Taxpayer Relief Act of 1997 (P.L. 105-34), the Balanced Budget Act of 1997 (P.L. 105-33), and the Taxpayer Browsing Protection Act of 1997 (P.L. 105-35) is shown below. For your convenience, all three laws are presented in one consolidated section. Amendments from the Taxpayer Relief Act of 1997 have no headings. Amendments from the Balanced Budget Act of 1997 are listed under the heading "Balanced Budget Act." Amendments from the Taxpayer Browsing Protection Act of 1997 are listed under the heading "Taxpayer Browsing Act."

[¶ 5001] CODE SEC. 1. TAX IMPOSED.

* * *

(h) Maximum Capital Gains Rate.—

(1) In general.—If a taxpayer has a net capital gain for any taxable year, the tax imposed by this section for such taxable year shall not exceed the sum of—

(A) a tax computed at the rates and in the same manner as if this subsection had not been enacted on the greater of—

(i) taxable income reduced by the net capital gain, or

(ii) the lesser of—

(I) the amount of taxable income taxed at a rate below 28 percent, or

(II) taxable income reduced by the adjusted net capital gain, plus

(B) 25 percent of the excess (if any) of—

(i) the unrecaptured section 1250 gain (or, if less, the net capital gain), over

(ii) the excess (if any) of—

(I) the sum of the amount on which tax is determined under subparagraph (A) plus the net capital gain, over

(II) taxable income, plus

(C) 28 percent of the amount of taxable income in excess of the sum of—

(i) the adjusted net capital gain, plus

(ii) the sum of the amounts on which tax is determined under subparagraphs (A) and (B), plus

(D) 10 percent of so much of the taxpayer's adjusted net capital gain (or, if less, taxable income) as does not exceed the excess (if any) of—

(i) the amount of taxable income which would (without regard to this paragraph) be taxed at a rate below 28 percent, over

(ii) the taxable income reduced by the adjusted net capital gain, plus

(E) 20 percent of the taxpayer's adjusted net capital gain (or, if less, taxable income) in excess of the amount on which a tax is determined under subparagraph (D).

(2) Reduced capital gain rates for qualified 5-year gain.—

(A) Reduction in 10-percent rate.—In the case of any taxable year beginning after December 31, 2000, the rate under paragraph (1)(D) shall be 8 percent with respect to so much of the amount to which the 10-percent rate would otherwise apply as does not exceed qualified 5-year gain, and 10 percent with respect to the remainder of such amount.

(B) Reduction in 20-percent rate.—The rate under paragraph (1)(E) shall be 18 percent with respect to so much of the amount to which the 20-percent rate would otherwise apply as does not exceed the lesser of—

(i) the excess of qualified 5-year gain over the amount of such gain taken into account under subparagraph (A) of this paragraph, or

(ii) the amount of qualified 5-year gain (determined by taking into account only property the holding period for which begins after December 31, 2000), and 20 percent with respect to the remainder of such amount. For purposes of determining under the preceding sentence whether the holding period of property begins after December 31, 2000, the holding period of property acquired pursuant to the exercise of an option (or other right or obligation to acquire property) shall include the period such option (or other right or obligation) was held.

(3) NET CAPITAL GAIN TAKEN INTO ACCOUNT AS INVESTMENT INCOME.—For purposes of this subsection, the net capital gain for any taxable year shall be reduced (but not below zero) by the amount which the taxpayer takes into account as investment income under section 163(d)(4)(B)(iii).

(4) ADJUSTED NET CAPITAL GAIN.—For purposes of this subsection, the term "adjusted net capital gain" means net capital gain determined without regard to—

(A) collectibles gain,

(B) unrecaptured section 1250 gain,

(C) section 1202 gain, and

(D) mid-term gain.

(5) COLLECTIBLES GAIN.—For purposes of this subsection—

(A) IN GENERAL.—The term "collectibles gain" means gain from the sale or exchange of a collectible (as defined in section 408(m) without regard to paragraph (3) thereof) which is a capital asset held for more than 1 year but only to the extent such gain is taken into account in computing gross income.

(B) PARTNERSHIPS, ETC.—For purposes of subparagraph (A), any gain from the sale of an interest in a partnership, S corporation, or trust which is attributable to unrealized appreciation in the value of collectibles shall be treated as gain from the sale or exchange of a collectible. Rules similar to the rules of section 751 shall apply for purposes of the preceding sentence.

(6) UNRECAPTURED SECTION 1250 GAIN.—For purposes of this subsection—

(A) IN GENERAL.—The term "unrecaptured section 1250 gain" means the amount of long-term capital gain which would be treated as ordinary income if—

(i) section 1250(b)(1) included all depreciation and the applicable percentage under section 1250(a) were 100 percent, and

(ii) in the case of gain properly taken into account after July 28, 1997, only gain from section 1250 property held for more than 18 months were taken into account.

(B) LIMITATION WITH RESPECT TO SECTION 1231 PROPERTY.—The amount of unrecaptured section 1250 gain from sales, exchanges, and conversions described in section 1231(a)(3)(A) for any taxable year shall not exceed the excess of the net section 1231 gain (as defined in section 1231(c)(3)) for such year over the amount treated as ordinary income under section 1231(c)(1) for such year.

(C) PRE-MAY 7, 1997, GAIN.—In the case of a taxable year which includes May 7, 1997, subparagraph (A) shall be applied by taking into account only the gain properly taken into account for the portion of the taxable year after May 6, 1997.

(7) SECTION 1202 GAIN.—For purposes of this subsection, the term "section 1202 gain" means an amount equal to the gain excluded from gross income under section 1202(a).

(8) MID-TERM GAIN.—For purposes of this subsection, the term "mid-term gain" means the amount which would be adjusted net capital gain for the taxable year if—

(A) adjusted net capital gain were determined by taking into account only the gain or loss properly taken into account after July 28, 1997, from property held for more than 1 year but not more than 18 months, and

(B) paragraph (3) and section 1212 did not apply.

(9) QUALIFIED 5-YEAR GAIN.—For purposes of this subsection, the term "qualified 5-year gain" means the amount of long-term capital gain which would be computed for the taxable year if only gains from the sale or exchange of property held by the taxpayer for more than 5 years were taken into account. The determination under the preceding sentence shall be made without regard to collectibles gain, unrecaptured section 1250 gain (determined without regard to subparagraph (B) of paragraph (6)), section 1202 gain, or mid-term gain.

(10) PRE-EFFECTIVE DATE GAIN.—

(A) IN GENERAL.—In the case of a taxable year which includes May 7, 1997, gains and losses properly taken into account for the portion of the taxable year before May 7, 1997, shall be taken into account in determining mid-term gain as if such gains and losses were described in paragraph (8)(A).

(B) SPECIAL RULES FOR PASS-THRU ENTITIES.—In applying subparagraph (A) with respect to any pass-thru entity, the determination of when gains and loss are properly taken into account shall be made at the entity level.

(C) PASS-THRU ENTITY DEFINED.—For purposes of subparagraph (B), the term "pass-thru entity" means—

(i) a regulated investment company,

(ii) a real estate investment trust,

(iii) an S corporation,

(iv) a partnership,

(v) an estate or trust, and

(vi) a common trust fund.

(11) TREATMENT OF PASS-THRU ENTITIES.—The Secretary may prescribe such regulations as are appropriate (including regulations requiring reporting) to apply this subsection in the case of sales and exchanges by pass-thru entities (as defined in paragraph (10)(C)) and of interests in such entities.

* * *

[CCH Explanation at ¶ 301, 302 and 303. Committee Reports at ¶ 10,295.]

Amendment Notes

Act Sec. 311(a) amended Code Sec. 1(h) to read as above. Prior to amendment, Code Sec. 1(h) read as follows:

(h) MAXIMUM CAPITAL GAINS RATE.—If a taxpayer has a net capital gain for any taxable year, then the tax imposed by this section shall not exceed the sum of—

(1) a tax computed at the rates and in the same manner as if this subsection had not been enacted on the greater of—

(A) taxable income reduced by the amount of the net capital gain, or

(B) the amount of taxable income taxed at a rate below 28 percent, plus

(2) a tax of 28 percent of the amount of taxable income in excess of the amount determined under paragraph (1).

For purposes of the preceding sentence, the net capital gain for any taxable year shall be reduced (but not below zero) by the amount which the taxpayer elects to take into account as investment income for the taxable year under section 163(d)(4)(B)(iii).

The above amendment generally applies to tax years ending after May 6, 1997. For a special rule, see Act Sec. 311(e), below.

Act Sec. 311(e) provides:

(e) ELECTION TO RECOGNIZE GAIN ON ASSETS HELD ON JANUARY 1, 2001.—For purposes of the Internal Revenue Code of 1986—

(1) IN GENERAL.—A taxpayer other than a corporation may elect to treat—

(A) any readily tradable stock (which is a capital asset) held by such taxpayer on January 1, 2001, and not sold before the next business day after such date, as having been sold on such next business day for an amount equal to its closing market price on such next business day (and as having been reacquired on such next business day for an amount equal to such closing market price), and

(B) any other capital asset or property used in the trade or business (as defined in section 1231(b) of the Internal Revenue Code of 1986) held by the taxpayer on January 1, 2001, as having been sold on such date for an amount equal to its fair market value on such date (and as having been reacquired on such date for an amount equal to such fair market value).

(2) TREATMENT OF GAIN OR LOSS.—

(A) Any gain resulting from an election under paragraph (1) shall be treated as received or accrued on the date the asset is treated as sold under paragraph (1) and shall be recognized notwithstanding any provision of the Internal Revenue Code of 1986.

(B) Any loss resulting from an election under paragraph (1) shall not be allowed for any taxable year.

(3) ELECTION.—An election under paragraph (1) shall be made in such manner as the Secretary of the Treasury or his delegate may prescribe and shall specify the assets for which such election is made. Such an election, once made with respect to any asset, shall be irrevocable.

(4) READILY TRADABLE STOCK.—For purposes of this subsection, the term "readily tradable stock" means any stock which, as of January 1, 2001, is readily tradable on an established securities market or otherwise.

[¶ 5003] CODE SEC. 23. ADOPTION EXPENSES.

(a) ALLOWANCE OF CREDIT.—

* * *

(2) YEAR CREDIT ALLOWED.—The credit under paragraph (1) with respect to any expense shall be allowed—

(A) in the case of any expense paid or incurred before the taxable year in which such adoption becomes final, for the taxable year following the taxable year during which such expense is paid or incurred, and

(B) in the case of an expense paid or incurred during or after the taxable year in which such adoption becomes final, for the taxable year in which such expense is paid or incurred.

Amendment Notes

Act Sec. 1601(h)(2)(A) amended Code Sec. 23(a)(2) to read as above. Prior to amendment, Code Sec. 23(a)(2) read as follows:

(2) YEAR CREDIT ALLOWED.—The credit under paragraph (1) with respect to any expense shall be allowed—

(A) for the taxable year following the taxable year during which such expense is paid or incurred, or

(B) in the case of an expense which is paid or incurred during the taxable year in which the adoption becomes final, for such taxable year.

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

(b) LIMITATIONS.—

* * *

(2) INCOME LIMITATION.—

* * *

(B) DETERMINATION OF ADJUSTED GROSS INCOME.—For purposes of subparagraph (A), adjusted gross income shall be *determined without regard to sections 911, 931, and 933.*

* * *

[CCH Explanation at ¶ 122. Committee Reports at ¶ 13,685.]

Amendment Notes

Act Sec. 1601(h)(2)(B) amended Code Sec. 23(b)(2)(B) by striking "determined—" and all that follows and inserting "determined without regard to sections 911, 931, and 933.". Prior to amendment, Code Sec. 23(b)(2)(B) read as follows:

(B) DETERMINATION OF ADJUSTED GROSS INCOME.—For purposes of subparagraph (A), adjusted gross income shall be determined—

(i) without regard to sections 911, 931, and 933, and

(ii) after the application of sections 86, 135, 137, 219, and 469.

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

[¶ 5005] *CODE SEC. 24. CHILD TAX CREDIT.*

(a) ALLOWANCE OF CREDIT.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year with respect to each qualifying child of the taxpayer an amount equal to $500 ($400 in the case of taxable years beginning in 1998).

(b) LIMITATION BASED ON ADJUSTED GROSS INCOME.—

(1) IN GENERAL.—The amount of the credit allowable under subsection (a) shall be reduced (but not below zero) by $50 for each $1,000 (or fraction thereof) by which the taxpayer's modified adjusted gross income exceeds the threshold amount. For purposes of the preceding sentence, the term "modified adjusted gross income" means adjusted gross income increased by any amount excluded from gross income under section 911, 931, or 933.

(2) THRESHOLD AMOUNT.—For purposes of paragraph (1), the term "threshold amount" means—

(A) $110,000 in the case of a joint return,

(B) $75,000 in the case of an individual who is not married, and

(C) $55,000 in the case of a married individual filing a separate return.

For purposes of this paragraph, marital status shall be determined under section 7703.

(c) QUALIFYING CHILD.—For purposes of this section—

(1) IN GENERAL.—The term "qualifying child" means any individual if—

(A) the taxpayer is allowed a deduction under section 151 with respect to such individual for the taxable year,

(B) such individual has not attained the age of 17 as of the close of the calendar year in which the taxable year of the taxpayer begins, and

(C) such individual bears a relationship to the taxpayer described in section 32(c)(3)(B).

(2) EXCEPTION FOR CERTAIN NONCITIZENS.—The term "qualifying child" shall not include any individual who would not be a dependent if the first sentence of section 152(b)(3) were applied without regard to all that follows "resident of the United States".

(d) ADDITIONAL CREDIT FOR FAMILIES WITH 3 OR MORE CHILDREN.—

(1) In general.—In the case of a taxpayer with 3 or more qualifying children for any taxable year, the amount of the credit allowed under this section shall be equal to the greater of—

(A) the amount of the credit allowed under this section (without regard to this subsection and after application of the limitation under section 26), or

(B) the alternative credit amount determined under paragraph (2).

(2) Alternative credit amount.—For purposes of this subsection, the alternative credit amount is the amount of the credit which would be allowed under this section if the limitation under paragraph (3) were applied in lieu of the limitation under section 26.

(3) Limitation.—The limitation under this paragraph for any taxable year is the limitation under section 26 (without regard to this subsection)—

(A) increased by the taxpayer's social security taxes for such taxable year, and

(B) reduced by the sum of—

(i) the credits allowed under this part other than under subpart C or this section, and

(ii) the credit allowed under section 32 without regard to subsection (m) thereof.

(4) Unused credit to be refundable.—If the amount of the credit under paragraph (1)(B) exceeds the amount of the credit under paragraph (1)(A), such excess shall be treated as a credit to which subpart C applies. The rule of section 32(h) shall apply to such excess.

(5) Social security taxes.—For purposes of paragraph (3)—

(A) In general.—The term "social security taxes" means, with respect to any taxpayer for any taxable year—

(i) the amount of the taxes imposed by sections 3101 and 3201(a) on amounts received by the taxpayer during the calendar year in which the taxable year begins,

(ii) 50 percent of the taxes imposed by section 1401 on the self-employment income of the taxpayer for the taxable year, and

(iii) 50 percent of the taxes imposed by section 3211(a)(1) on amounts received by the taxpayer during the calendar year in which the taxable year begins.

(B) Coordination with special refund of social security taxes.—The term "social security taxes" shall not include any taxes to the extent the taxpayer is entitled to a special refund of such taxes under section 6413(c).

(C) Special rule.—Any amounts paid pursuant to an agreement under section 3121(l) (relating to agreements entered into by American employers with respect to foreign affiliates) which are equivalent to the taxes referred to in subparagraph (A)(i) shall be treated as taxes referred to in such subparagraph.

(e) Identification Requirement.—No credit shall be allowed under this section to a taxpayer with respect to any qualifying child unless the taxpayer includes the name and taxpayer identification number of such qualifying child on the return of tax for the taxable year.

(f) Taxable Year Must Be Full Taxable Year.—Except in the case of a taxable year closed by reason of the death of the taxpayer, no credit shall be allowable under this section in the case of a taxable year covering a period of less than 12 months.

[CCH Explanation at ¶ 119. Committee Reports at ¶ 10,115.]

Amendment Notes

Act Sec. 101(a) amended subpart A of part IV of subchapter A of chapter 1 by inserting after Code Sec. 23 a new Code Sec. 24 to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5007] CODE SEC. 25. INTEREST ON CERTAIN HOME MORTGAGES.

* * *

(e) Special Rules and Definitions.—For purposes of this section—

* * *

(7) Principal residence.—The term "principal residence" has the same meaning as when used in *section 121.*

* * *

[CCH Explanation at ¶ 129. Committee Reports at ¶ 10,315.]

Amendment Notes

Act Sec. 312(d)(1) amended Code Sec. 25(e)(7) by striking "section 1034" and inserting "section 121".

The above amendment applies to sales and exchanges after May 6, 1997.

[¶ 5009] *CODE SEC. 25A. HOPE AND LIFETIME LEARNING CREDITS.*

(a) ALLOWANCE OF CREDIT.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year the amount equal to the sum of—

(1) the Hope Scholarship Credit, plus

(2) the Lifetime Learning Credit.

(b) HOPE SCHOLARSHIP CREDIT.—

(1) PER STUDENT CREDIT.—In the case of any eligible student for whom an election is in effect under this section for any taxable year, the Hope Scholarship Credit is an amount equal to the sum of—

(A) 100 percent of so much of the qualified tuition and related expenses paid by the taxpayer during the taxable year (for education furnished to the eligible student during any academic period beginning in such taxable year) as does not exceed $1,000, plus

(B) 50 percent of such expenses so paid as exceeds $1,000 but does not exceed the applicable limit.

(2) LIMITATIONS APPLICABLE TO HOPE SCHOLARSHIP CREDIT.—

(A) CREDIT ALLOWED ONLY FOR 2 TAXABLE YEARS.—An election to have this section apply with respect to any eligible student for purposes of the Hope Scholarship Credit under subsection (a)(1) may not be made for any taxable year if such an election (by the taxpayer or any other individual) is in effect with respect to such student for any 2 prior taxable years.

(B) CREDIT ALLOWED FOR YEAR ONLY IF INDIVIDUAL IS AT LEAST 1/2 TIME STUDENT FOR PORTION OF YEAR.—The Hope Scholarship Credit under subsection (a)(1) shall not be allowed for a taxable year with respect to the qualified tuition and related expenses of an individual unless such individual is an eligible student for at least one academic period which begins during such year.

(C) CREDIT ALLOWED ONLY FOR FIRST 2 YEARS OF POSTSECONDARY EDUCATION.—The Hope Scholarship Credit under subsection (a)(1) shall not be allowed for a taxable year with respect to the qualified tuition and related expenses of an eligible student if the student has completed (before the beginning of such taxable year) the first 2 years of postsecondary education at an eligible educational institution.

(D) DENIAL OF CREDIT IF STUDENT CONVICTED OF A FELONY DRUG OFFENSE.—The Hope Scholarship Credit under subsection (a)(1) shall not be allowed for qualified tuition and related expenses for the enrollment or attendance of a student for any academic period if such student has been convicted of a Federal or State felony offense consisting of the possession or distribution of a controlled substance before the end of the taxable year with or within which such period ends.

(3) ELIGIBLE STUDENT.—For purposes of this subsection, the term "eligible student" means, with respect to any academic period, a student who—

(A) meets the requirements of section 484(a)(1) of the Higher Education Act of 1965 (20 U.S.C. 1091(a)(1)), as in effect on the date of the enactment of this section, and

(B) is carrying at least ½ the normal full-time work load for the course of study the student is pursuing.

(4) APPLICABLE LIMIT.—For purposes of paragraph (1)(B), the applicable limit for any taxable year is an amount equal to 2 times the dollar amount in effect under paragraph (1)(A) for such taxable year.

(c) LIFETIME LEARNING CREDIT.—

(1) PER TAXPAYER CREDIT.—The Lifetime Learning Credit for any taxpayer for any taxable year is an amount equal to 20 percent of so much of the qualified tuition and related expenses paid by the taxpayer during the taxable year (for education furnished during any academic period beginning in such taxable year) as does not exceed $10,000 ($5,000 in the case of taxable years beginning before January 1, 2003).

(2) SPECIAL RULES FOR DETERMINING EXPENSES.—

(A) COORDINATION WITH HOPE SCHOLARSHIP.—The qualified tuition and related expenses with respect to an individual who is an eligible student for whom a Hope Scholarship Credit under subsection (a)(1) is allowed for the taxable year shall not be taken into account under this subsection.

(B) Expenses eligible for lifetime learning credit.—For purposes of paragraph (1), qualified tuition and related expenses shall include expenses described in subsection (f)(1) with respect to any course of instruction at an eligible educational institution to acquire or improve job skills of the individual.

(d) Limitation Based on Modified Adjusted Gross Income.—

(1) In general.—The amount which would (but for this subsection) be taken into account under subsection (a) for the taxable year shall be reduced (but not below zero) by the amount determined under paragraph (2).

(2) Amount of reduction.—The amount determined under this paragraph is the amount which bears the same ratio to the amount which would be so taken into account as—

(A) the excess of—

(i) the taxpayer's modified adjusted gross income for such taxable year, over

(ii) $40,000 ($80,000 in the case of a joint return), bears to

(B) $10,000 ($20,000 in the case of a joint return).

(3) Modified adjusted gross income.—The term "modified adjusted gross income" means the adjusted gross income of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933.

(e) Election To Have Section Apply.—

(1) In general.—No credit shall be allowed under subsection (a) for a taxable year with respect to the qualified tuition and related expenses of an individual unless the taxpayer elects to have this section apply with respect to such individual for such year.

(2) Coordination with exclusions.—An election under this subsection shall not take effect with respect to an individual for any taxable year if any portion of any distribution during such taxable year from an education individual retirement account is excluded from gross income under section 530(d)(2).

(f) Definitions.—For purposes of this section—

(1) Qualified tuition and related expenses.—

(A) In general.—The term "qualified tuition and related expenses" means tuition and fees required for the enrollment or attendance of—

(i) the taxpayer,

(ii) the taxpayer's spouse, or

(iii) any dependent of the taxpayer with respect to whom the taxpayer is allowed a deduction under section 151, at an eligible educational institution for courses of instruction of such individual at such institution.

(B) Exception for education involving sports, etc.—Such term does not include expenses with respect to any course or other education involving sports, games, or hobbies, unless such course or other education is part of the individual's degree program.

(C) Exception for nonacademic fees.—Such term does not include student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic course of instruction.

(2) Eligible educational institution.—The term "eligible educational institution" means an institution—

(A) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on the date of the enactment of this section, and

(B) which is eligible to participate in a program under title IV of such Act.

(g) Special Rules.—

(1) Identification requirement.—No credit shall be allowed under subsection (a) to a taxpayer with respect to the qualified tuition and related expenses of an individual unless the taxpayer includes the name and taxpayer identification number of such individual on the return of tax for the taxable year.

(2) Adjustment for certain scholarships, etc.—The amount of qualified tuition and related expenses otherwise taken into account under subsection (a) with respect to an individual for an academic period shall be reduced (before the application of subsections (b), (c), and (d)) by the sum of any amounts paid for the benefit of such individual which are allocable to such period as—

(A) a qualified scholarship which is excludable from gross income under section 117,

(B) an educational assistance allowance under chapter 30, 31, 32, 34, or 35 of title 38, United States Code, or under chapter 1606 of title 10, United States Code, and

(C) a payment (other than a gift, bequest, devise, or inheritance within the meaning of section 102(a)) for such individual's educational expenses, or attributable to such individual's enrollment at an eligible educational institution, which is excludable from gross income under any law of the United States.

(3) TREATMENT OF EXPENSES PAID BY DEPENDENT.—If a deduction under section 151 with respect to an individual is allowed to another taxpayer for a taxable year beginning in the calendar year in which such individual's taxable year begins—

(A) no credit shall be allowed under subsection (a) to such individual for such individual's taxable year, and

(B) qualified tuition and related expenses paid by such individual during such individual's taxable year shall be treated for purposes of this section as paid by such other taxpayer.

(4) TREATMENT OF CERTAIN PREPAYMENTS.—If qualified tuition and related expenses are paid by the taxpayer during a taxable year for an academic period which begins during the first 3 months following such taxable year, such academic period shall be treated for purposes of this section as beginning during such taxable year.

(5) DENIAL OF DOUBLE BENEFIT.—No credit shall be allowed under this section for any expense for which a deduction is allowed under any other provision of this chapter.

(6) NO CREDIT FOR MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—If the taxpayer is a married individual (within the meaning of section 7703), this section shall apply only if the taxpayer and the taxpayer's spouse file a joint return for the taxable year.

(7) NONRESIDENT ALIENS.—If the taxpayer is a nonresident alien individual for any portion of the taxable year, this section shall apply only if such individual is treated as a resident alien of the United States for purposes of this chapter by reason of an election under subsection (g) or (h) of section 6013.

(h) INFLATION ADJUSTMENTS.—

(1) DOLLAR LIMITATION ON AMOUNT OF CREDIT.—

(A) IN GENERAL.—In the case of a taxable year beginning after 2001, each of the $1,000 amounts under subsection (b)(1) shall be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "calendar year 2000" for "calendar year 1992" in subparagraph (B) thereof.

(B) ROUNDING.—If any amount as adjusted under subparagraph (A) is not a multiple of $100, such amount shall be rounded to the next lowest multiple of $100.

(2) INCOME LIMITS.—

(A) IN GENERAL.—In the case of a taxable year beginning after 2001, the $40,000 and $80,000 amounts in subsection (d)(2) shall each be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "calendar year 2000" for "calendar year 1992" in subparagraph (B) thereof.

(B) ROUNDING.—If any amount as adjusted under subparagraph (A) is not a multiple of $1,000, such amount shall be rounded to the next lowest multiple of $1,000.

(i) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary or appropriate to carry out this section, including regulations providing for a recapture of the credit allowed under this section in cases where there is a refund in a subsequent taxable year of any amount which was taken into account in determining the amount of such credit.

[CCH Explanation at ¶ 139. Committee Reports at ¶ 10,135.]

Amendment Notes

Act Sec. 201(a) amended subpart A of part IV of subchapter A of chapter 1 by inserting after Code Sec. 25 a new Code Sec. 25A to read as above.

The above amendment generally applies to expenses paid after December 31, 1997 (in tax years ending after such date), for education furnished in academic periods

beginning after such date. For a special rule, see Act Sec. 201(f)(2), below.

Act Sec. 201(f)(2) provides:

(2) LIFETIME LEARNING CREDIT.—Section 25A(a)(2) of the Internal Revenue Code of 1986 shall apply to expenses paid after June 30, 1998 (in taxable years ending after such date), for education furnished in academic periods beginning after such dates.

[¶ 5011] CODE SEC. 26. LIMITATION BASED ON TAX LIABILITY; DEFINITION OF TAX LIABILITY.

* * *

(b) REGULAR TAX LIABILITY.—For purposes of this part—

* * *

(2) EXCEPTION FOR CERTAIN TAXES.—For purposes of paragraph (1), any tax imposed by any of the following provisions shall not be treated as tax imposed by this chapter:

(A) section 55 (relating to minimum tax),

(B) section 59A (relating to environmental tax),

(C) subsection (m)(5)(B), (q), (t), or (v) of section 72 (relating to additional taxes on certain distributions),

(D) section 143(m) (relating to recapture of proration of Federal subsidy from use of mortgage bonds and mortgage credit certificates),

(E) section 530(d)(3) (relating to additional tax on certain distributions from education individual retirement accounts),

(F) section 531 (relating to accumulated earnings tax),

(G) section 541 (relating to personal holding company tax),

(H) section 1351(d)(1) (relating to recoveries of foreign expropriation losses),

(I) section 1374 (relating to tax on certain certain built-in gains of S corporations),

(J) section 1375 (relating to tax imposed when passive investment income of corporation having subchapter C earnings and profits exceeds 25 percent of gross receipts),

(K) subparagraph (A) of section 7518(g)(6) (relating to nonqualified withdrawals from capital construction funds taxed at highest marginal rate),

(L) sections 871(a) and 881 (relating to certain income of nonresident aliens and foreign corporations),

(M) section 860E(e) (relating to taxes with respect to certain residual interests),

(N) section 884 (relating to branch profits tax),

(O) sections 453(l)(3) and 453A(c) (relating to interest on certain deferred tax liabilities),

(P) section 860K (relating to treatment of transfers of high-yield interests to disqualified holders), *and*

(Q) section 220(f)(4) (relating to additional tax on medical savings account distributions not used for qualified medical expenses).

* * *

[CCH Explanation at ¶ 145 and 801. Committee Reports at ¶ 10,185 and 13,755.]

Amendment Notes

Act Sec. 213(e)(1) amended Code Sec. 26(b)(2) by redesignating subparagraphs (E) through (P) as subparagraphs (F) through (Q), respectively, and by inserting after subparagraph (D) a new subparagraph (E) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

Act Sec. 1602(a)(1) amended Code Sec. 26(b)(2) by striking "and" at the end of subparagraph (N), by striking the period at the end of subparagraph (O) and inserting ", and", and by adding at the end a new subparagraph (P) to read as above.

The above amendment is effective as if included in the provisions of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

[¶ 5013] CODE SEC. 30A. *PUERTO RICO ECONOMIC ACTIVITY CREDIT.*

* * *

Amendment Notes

Act Sec. 1601(f)(1)(A) amended Code Sec. 30A by changing the heading to read as above. Prior to amendment, the heading of Code Sec. 30A read as follows:

SEC. 30A. PUERTO RICAN ECONOMIC ACTIVITY CREDIT.

The above amendment is effective as if included in the provisions of the Small Business Job Protection Act of

1996 (P.L. 104-188) to which it relates [generally effective for tax years beginning after December 31, 1995.—CCH.].

[¶ 5015] CODE SEC. 32. EARNED INCOME.

* * *

(c) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

* * *

(2) EARNED INCOME.—

* * *

(B) For purposes of subparagraph (A)—

(i) the earned income of an individual shall be computed without regard to any community property laws,

(ii) no amount received as a pension or annuity shall be taken into account,

(iii) no amount to which section 871(a) applies (relating to income of nonresident alien individuals not connected with United States business) shall be taken into account,

(iv) no amount received for services provided by an individual while the individual is an inmate at a penal institution shall be taken into account, *and*

(v) no amount described in subparagraph (A) received for service performed in work activities as defined in paragraph (4) or (7) of section 407(d) of the Social Security Act to which the taxpayer is assigned under any State program under part A of title IV of such Act, but only to the extent such amount is subsidized under such State program.

* * *

(4) TREATMENT OF MILITARY PERSONNEL STATIONED OUTSIDE THE UNITED STATES.—For purposes of paragraphs (1)(A)(ii)(I) and (3)(E), the principal place of abode of a member of the Armed Forces of the United States shall be treated as in the United States during any period during which such member is stationed outside the United States while serving on extended active duty with the Armed Forces of the United States. *For purposes of the preceding sentence, the term "extended active duty" means any period of active duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period.*

(5) MODIFIED ADJUSTED GROSS INCOME.—

* * *

(B) CERTAIN AMOUNTS DISREGARDED.—An amount is described in this subparagraph if it is—

(i) the amount of losses from sales or exchanges of capital assets in excess of gains from such sales or exchanges to the extent such amount does not exceed the amount under section 1211(b)(1),

(ii) the net loss from estates and trusts,

(iii) the excess (if any) of amounts described in subsection (i)(2)(C)(ii) over the amounts described in subsection (i)(2)(C)(i) (relating to nonbusiness rents and royalties),

(iv) *75 percent* of the net loss from the carrying on of trades or businesses, computed separately with respect to—

(I) trades or businesses (other than farming) conducted as sole proprietorships,

(II) trades or businesses of farming conducted as sole proprietorships, and

(III) other trades or businesses[,]

(v) interest received or accrued during the taxable year which is exempt from tax imposed by this chapter, and

(vi) amounts received as a pension or annuity, and any distributions or payments received from an individual retirement plan, by the taxpayer during the taxable year to the extent not included in gross income.

For purposes of clause (iv), there shall not be taken into account items which are attributable to a trade or business which consists of the performance of services by the taxpayer as an employee. Clause (vi) shall not include any amount which is not includible in gross income by reason of section 402(c), 403(a)(4), 403(b), 408(d)(3), (4), or (5), or 457(e)(10).

* * *

Amendment Notes

Act Sec. 312(d)(2) amended Code Sec. 32(c)(4) by striking "(as defined in section 1034(h)(3))" after "extended active duty" and by adding at the end a new sentence to read as above.

The above amendment generally applies to sales and exchanges after May 6, 1997.

Act Sec. 1085(b) amended Code Sec. 32(c)(5)(B)(iv) by striking "50 percent" and inserting "75 percent".

Act Sec. 1085(c) amended Code Sec. 32(c)(2)(B) by striking "and" at the end of clause (iii), by striking the period at the end of clause (iv) and inserting ", and", and by adding at the end a new clause (v) to read as above.

Act Sec. 1085(d)(1)-(4) amended Code Sec. 32(c)(5)(B) by striking "and" at the end of clause (iii), by striking the period at the end of clause (iv)(III), by inserting after clause (iv)(III) new clauses (v) and (vi) to read as above, and by adding at the end a new sentence to read as above.

The above amendments apply to tax years beginning after December 31, 1997.

(k) RESTRICTIONS ON TAXPAYERS WHO IMPROPERLY CLAIMED CREDIT IN PRIOR YEAR.—

(1) TAXPAYERS MAKING PRIOR FRAUDULENT OR RECKLESS CLAIMS.—

(A) IN GENERAL.—No credit shall be allowed under this section for any taxable year in the disallowance period.

(B) DISALLOWANCE PERIOD.—For purposes of paragraph (1), the disallowance period is—

(i) the period of 10 taxable years after the most recent taxable year for which there was a final determination that the taxpayer's claim of credit under this section was due to fraud, and

(ii) the period of 2 taxable years after the most recent taxable year for which there was a final determination that the taxpayer's claim of credit under this section was due to reckless or intentional disregard of rules and regulations (but not due to fraud).

(2) TAXPAYERS MAKING IMPROPER PRIOR CLAIMS.—In the case of a taxpayer who is denied credit under this section for any taxable year as a result of the deficiency procedures under subchapter B of chapter 63, no credit shall be allowed under this section for any subsequent taxable year unless the taxpayer provides such information as the Secretary may require to demonstrate eligibility for such credit.

Amendment Notes

Act Sec. 1085(a)(1) amended Code Sec. 32 by redesignating subsections (k) and (l) [and (m) as added by Act Sec. 101(b)] as subsections (l) and (m) [and (n)], respectively, and by inserting after subsection (j) a new subsection (k) to read as above.

The above amendment applies to tax years beginning after December 31, 1996.

(l) COORDINATION WITH CERTAIN MEANS-TESTED PROGRAMS.—For purposes of—

(1) the United States Housing Act of 1937,

(2) title V of the Housing Act of 1949,

(3) section 101 of the Housing and Urban Development Act of 1965,

(4) sections 221(d)(3), 235, and 236 of the National Housing Act, and

(5) the Food Stamp Act of 1977,

any refund made to an individual (or the spouse of an individual) by reason of this section, and any payment made to such individual (or such spouse) by an employer under section 3507, shall not be treated as income (and shall not be taken into account in determining resources for the month of its receipt and the following month).

Amendment Notes

Act Sec. 1085(a)(1) amended Code Sec. 32 by redesignating subsection (k) as subsection (l).

The above amendment applies to tax years beginning after December 31, 1996.

(m) IDENTIFICATION NUMBERS.—Solely for purposes of subsections (c)(1)(F) and (c)(3)(D), a taxpayer identification number means a social security number issued to an individual by the Social Security Administration (other than a social security number issued pursuant to clause (II) (or that portion of clause (III) that relates to clause (II)) of section 205(c)(2)(B)(i) of the Social Security Act).

Amendment Notes

Act Sec. 1085(a)(1) amended Code Sec. 32 by redesignating subsection (l) as subsection (m).

The above amendment applies to tax years beginning after December 31, 1996.

(m) [(n)] SUPPLEMENTAL CHILD CREDIT.—

(1) IN GENERAL.—In the case of a taxpayer with respect to whom a credit is allowed under section 24 for the taxable year, there shall be allowed as a credit under this section an amount equal to the supplemental child credit (if any) determined for such taxpayer for such taxable year under paragraph (2). Such credit shall be in addition to the credit allowed under subsection (a).

(2) SUPPLEMENTAL CHILD CREDIT.—For purposes of this subsection, the supplemental child credit is an amount equal to the excess (if any) of—

(A) the amount determined under section 24(d)(1)(A), over

(B) the amount determined under section 24(d)(1)(B).

The amounts referred to in subparagraphs (A) and (B) shall be determined as if section 24(d) applied to all taxpayers.

(3) COORDINATION WITH SECTION 24.—The amount of the credit under section 24 shall be reduced by the amount of the credit allowed under this subsection.

* * *

[CCH Explanation at ¶ 119, 127 and 129. Committee Reports at ¶ 10,115, 10,315, 11,535, 11,538 and 11,539.]

Amendment Notes

Act Sec. 101(b) amended Code Sec. 32 by adding a new subsection (m)[(n)] to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5017] CODE SEC. 39. CARRYBACK AND CARRYFORWARD OF UNUSED CREDITS.

(a) IN GENERAL.—

(1) *1*-YEAR CARRYBACK AND *20*-YEAR CARRYFORWARD.—If the sum of the business credit carryforwards to the taxable year plus the amount of the current year business credit for the taxable year exceeds the amount of the limitation imposed by subsection (c) of section 38 for such taxable year (hereinafter in this section referred to as the "unused credit year"), such excess (to the extent attributable to the amount of the current year business credit) shall be—

(A) a business credit carryback to each of the *1* taxable years preceding the unused credit year, and

(B) a business credit carryforward to each of the *20* taxable years following the unused credit year,

and, subject to the limitations imposed by subsections (b) and (c), shall be taken into account under the provisions of section 38(a) in the manner provided in section 38(a).

(2) AMOUNT CARRIED TO EACH YEAR.—

(A) ENTIRE AMOUNT CARRIED TO FIRST YEAR.—The entire amount of the unused credit for an unused credit year shall be carried to the earliest of the *22* taxable years to which (by reason of paragraph (1)) such credit may be carried.

(B) AMOUNT CARRIED TO OTHER *21* YEARS.—The amount of the unused credit for the unused credit year shall be carried to each of the other *21* taxable years to the extent that such unused credit may not be taken into account under section 38(a) for a prior taxable year because of the limitations of subsections (b) and (c).

* * *

Amendment Notes

Act Sec. 1083(a)(1) amended Code Sec. 39(a)(1) by striking "3" each place it appears and inserting "1" and by striking "15" each place it appears and inserting "20".

Act Sec. 1083(a)(2) amended Code Sec. 39(a)(2) by striking "18" each place it appears and inserting "22" and by striking "17" each place it appears and inserting "21".

The above amendments apply to credits arising in tax years beginning after December 31, 1997.

(d) TRANSITIONAL RULES.—

* * *

(8) NO CARRYBACK OF DC ZONE CREDITS BEFORE EFFECTIVE DATE.—No portion of the unused business credit for any taxable year which is attributable to the credits allowable under subchapter U by reason of section 1400 may be carried back to a taxable year ending before the date of the enactment of section 1400.

[CCH Explanation at ¶ 321, 381 and 387. Committee Reports at ¶ 10,465 and 11,525.]

Amendment Notes

Act Sec. 701(b)(1) amended Code Sec. 39(d) by adding a new paragraph (8) to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5019] CODE SEC. 41. CREDIT FOR INCREASING RESEARCH ACTIVITIES.

* * *

(c) BASE AMOUNT.—

* * *

(4) ELECTION OF ALTERNATIVE INCREMENTAL CREDIT.—

* * *

(B) ELECTION.—An election under this paragraph shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary.

* * *

Amendment Notes

Act Sec. 601(b)(1) amended Code Sec. 41(c)(4)(B) to read as above. Prior to amendment, Code Sec. 41(c)(4)(B) read as follows:

(B) ELECTION.—An election under this paragraph may be made only for the first taxable year of the taxpayer beginning after June 30, 1996. Such an election shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary.

The above amendment applies to amounts paid or incurred after May 31, 1997.

(h) TERMINATION.—

(1) IN GENERAL.—This section shall not apply to any amount paid or incurred—

(A) after June 30, 1995, and before July 1, 1996, or

(B) after *June 30, 1998.*

Notwithstanding the preceding sentence, in the case of a taxpayer making an election under subsection (c)(4) for its first taxable year beginning after June 30, 1996, and before July 1, 1997, this section shall apply to amounts paid or incurred *during the 24-month period beginning with the first month of such year. The 24 months referred to in the preceding sentence shall be reduced by the number of full months after June 1996 (and before the first month of such first taxable year) during which the taxpayer paid or incurred any amount which is taken into account in determining the credit under this section.*

* * *

[CCH Explanation at ¶ 317. Committee Reports at ¶ 10,435.]

Amendment Notes

Act Sec. 601(a)(1)-(2) amended Code Sec. 41(h)(1) by striking "May 31, 1997" and inserting "June 30, 1998", and by striking in the last sentence "during the first 11 months of such taxable year." and inserting "during the 24-month period beginning with the first month of such year. The 24 months referred to in the preceding sentence shall be reduced by the number of full months after June 1996 (and before the first month of such first taxable year) during which the taxpayer paid or incurred any amount which is taken into account in determining the credit under this section.".

The above amendment applies to amounts paid or incurred after May 31, 1997.

[¶ 5021] CODE SEC. 45C. CLINICAL TESTING EXPENSES FOR CERTAIN DRUGS FOR RARE DISEASES OR CONDITIONS.

* * *

(b) QUALIFIED CLINICAL TESTING EXPENSES.—For purposes of this section—

(1) QUALIFIED CLINICAL TESTING EXPENSES.—

* * *

(D) SPECIAL RULE.—For purposes of this paragraph, section 41 shall be deemed to remain in effect for periods after June 30, 1995, and before July 1, 1996, and periods after *June 30, 1998.*

* * *

Amendment Notes

Act Sec. 601(b)(2) amended Code Sec. 45C(b)(1)[(D)] by striking "May 31, 1997" and inserting "June 30, 1998".

The above amendment applies to amounts paid or incurred after May 31, 1997.

(e) *[Stricken.]*

* * *

[CCH Explanation at ¶ 317 and 319. Committee Reports at ¶ 10,435 and 10,450.]

Amendment Notes

Act Sec. 604(a) amended Code Sec. 45C by striking subsection (e). Prior to being stricken, Code Sec. 45C(e) read as follows:

(e) TERMINATION.—This section shall not apply to any amount paid or incurred—

(1) after December 31, 1994, and before July 1, 1996, or

(2) after May 31, 1997.

The above amendment applies to amounts paid or incurred after May 31, 1997.

[¶ 5023] **CODE SEC. 51. AMOUNT OF CREDIT.**

(a) DETERMINATION OF AMOUNT.—For purposes of section 38, the amount of the work opportunity credit determined under this section for the taxable year shall be equal to *40 percent* of the qualified first-year wages for such year.

* * *

Amendment Notes

Act Sec. 603(d)(1) amended Code Sec. 51(a) by striking "35 percent" and inserting "40 percent".

The above amendment applies to individuals who begin work for the employer after September 30, 1997.

(c) WAGES DEFINED.—For purposes of this subpart—

* * *

(4) TERMINATION.—The term "wages" shall not include any amount paid or incurred to an individual who begins work for the employer—

(A) after December 31, 1994, and before October 1, 1996, or

(B) after *June 30, 1998.*

Amendment Notes

Act Sec. 603(a) amended Code Sec. 51(c)(4)(B) by striking "September 30, 1997" and inserting "June 30, 1998".

The above amendment applies to individuals who begin work for the employer after September 30, 1997.

(d) MEMBERS OF TARGETED GROUPS.—For purposes of this subpart—

(1) IN GENERAL.—An individual is a member of a targeted group if such individual is—

(A) a qualified IV-A recipient,

(B) a qualified veteran,

(C) a qualified ex-felon,

(D) a high-risk youth,

(E) a vocational rehabilitation referral,

(F) a qualified summer youth employee,

(G) a qualified food stamp recipient, *or*

(H) a qualified SSI recipient.

(2) QUALIFIED IV-A RECIPIENT.—

(A) IN GENERAL.—The term "qualified IV-A recipient" means any individual who is certified by the designated local agency as being a member of a family receiving assistance under a IV-A program *for any 9 months during the 18-month period ending on the hiring date.*

* * *

(3) QUALIFIED VETERAN.—

(A) IN GENERAL.—The term "qualified veteran" means any veteran who is certified by the designated local agency as being a member of a family receiving assistance under a food stamp program under the Food Stamp Act of 1977 for at least a 3-month period ending during the 12-month period ending on the hiring date.

* * *

***[Caution: Code 51(d)(9), below, is shown as amended by the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193). However, Act Sec. 5514(a)(1) of the Balanced Budget Act of 1997 struck the provision of the Welfare Act (Act Sec. 110(l)(1)) that made this amendment. Thus, the amendment below never took effect.—CCH.*]**

(9) ELIGIBLE WORK INCENTIVE EMPLOYEES.—The term "eligible work incentive employee" means an individual who has been certified by the designated local agency as *being eligible for financial assistance under part A of title IV of the Social Security Act and as having continually received such financial assistance during the 90-day period which immediately precedes the date on which such individual is hired by the employer.*

(9) QUALIFIED SSI RECIPIENT.—The term "qualified SSI recipient" means any individual who is certified by the designated local agency as receiving supplemental security income benefits under title XVI of the Social Security Act (including supplemental security income benefits of the type described in section 1616 of such Act or section 212 of Public Law 93-66) for any month ending within the 60-day period ending on the hiring date.

(10) HIRING DATE.—The term "hiring date" means the day the individual is hired by the employer.

(11) DESIGNATED LOCAL AGENCY.—The term "designated local agency" means a State employment security agency established in accordance with the Act of June 6, 1933, as amended (29 U.S.C. 49-49n).

(12) SPECIAL RULES FOR CERTIFICATIONS.—

* * *

Amendment Notes

Act Sec. 603(b)(1) amended Code Sec. 51(d)(2)(A) by striking all that follows "a IV-A program" and inserting "for any 9 months during the 18-month period ending on the hiring date.".

Act Sec. 603(b)(2) amended Code Sec. 51(d)(3)(A) to read as above. Prior to amendment, Code Sec. 51(d)(3)(A) read as follows:

(A) IN GENERAL.—The term "qualified veteran" means any veteran who is certified by the designated local agency as being—

(i) a member of a family receiving assistance under a IV-A program (as defined in paragraph (2)(B)) for at least a 9-month period ending during the 12-month period ending on the hiring date, or

(ii) a member of a family receiving assistance under a food stamp program under the Food Stamp Act of 1977 for at least a 3-month period ending during the 12-month period ending on the hiring date.

Act Sec. 603(c)(1) amended Code Sec. 51(d)(1) by striking "or" at the end of subparagraph (F), by striking the period at the end of subparagraph (G) and inserting ", or", and by adding a new subparagraph (H) to read as above.

Act Sec. 603(c)(2) amended Code Sec. 51(d) by redesignating paragraphs (9), (10), and (11) as paragraphs (10), (11), and (12), respectively, and by inserting after paragraph (8) a new paragraph (9) to read as above.

The above amendments apply to individuals who begin work for the employer after September 30, 1997.

Balanced Budget Act

Act Sec. 5514(a)(1) struck the change made by the Personal Responsibility and Work Opportunity Act of 1996 (P.L. 104-193), which amended Code Sec. 51(d)(9) by striking all that followed "agency as" and inserted "being eligible for financial assistance under part A of title IV of the Social Security Act and as having continually received such financial assistance during the 90-day period which immediately precedes the date on which such individual is hired by the employer". Thus, the amendment to Code Sec. 51(d)(9) by P.L. 104-193 never took effect.

The above amendment is effective on July 1, 1997.

(i) CERTAIN INDIVIDUALS INELIGIBLE.—

* * *

(3) INDIVIDUALS NOT MEETING MINIMUM EMPLOYMENT PERIODS.—

(A) REDUCTION OF CREDIT FOR INDIVIDUALS PERFORMING FEWER THAN 400 HOURS OF SERVICE.—In the case of an individual who has performed at least 120 hours, but less than 400 hours, of service for the employer, subsection (a) shall be applied by substituting "25 percent" for "40 percent".

(B) DENIAL OF CREDIT FOR INDIVIDUALS PERFORMING FEWER THAN 120 HOURS OF SERVICE.—No wages shall be taken into account under subsection (a) with respect to any individual unless such individual has performed at least 120 hours of service for the employer.

* * *

[CCH Explanation at ¶ 318. Committee Reports at ¶ 10,445.]

Amendment Notes

Act Sec. 603(d)(2) amended Code Sec. 51(i)(3) to read as above. Prior to amendment, Code Sec. 51(i)(3) read as follows:

(3) INDIVIDUALS NOT MEETING MINIMUM EMPLOYMENT PERIOD.—No wages shall be taken into account under subsection (a) with respect to any individual unless such individual either—

(A) is employed by the employer at least 180 days (20 days in the case of a qualified summer youth employee), or

(B) has completed at least 400 hours (120 hours in the case of a qualified summer youth employee) of services performed for the employer.

The above amendment applies to individuals who begin work for the employer after September 30, 1997.

[¶ 5025] *CODE SEC. 51A. TEMPORARY INCENTIVES FOR EMPLOYING LONG-TERM FAMILY ASSISTANCE RECIPIENTS.*

(a) DETERMINATION OF AMOUNT.—For purposes of section 38, the amount of the welfare-to-work credit determined under this section for the taxable year shall be equal to—

(1) 35 percent of the qualified first-year wages for such year, and

(2) 50 percent of the qualified second-year wages for such year.

(b) QUALIFIED WAGES DEFINED.—For purposes of this section—

(1) In general.—The term "qualified wages" means the wages paid or incurred by the employer during the taxable year to individuals who are long-term family assistance recipients.

(2) Qualified first-year wages.—The term "qualified first-year wages" means, with respect to any individual, qualified wages attributable to service rendered during the 1-year period beginning with the day the individual begins work for the employer.

(3) Qualified second-year wages.—The term "qualified second-year wages" means, with respect to any individual, qualified wages attributable to service rendered during the 1-year period beginning on the day after the last day of the 1-year period with respect to such individual determined under paragraph (2).

(4) Only first $10,000 of wages per year taken into account.—The amount of the qualified first-year wages, and the amount of qualified second-year wages, which may be taken into account with respect to any individual shall not exceed $10,000 per year.

(5) Wages.—

(A) In general.—The term "wages" has the meaning given such term by section 51(c), without regard to paragraph (4) thereof.

(B) Certain amounts treated as wages.—The term "wages" includes amounts paid or incurred by the employer which are excludable from such recipient's gross income under—

(i) section 105 (relating to amounts received under accident and health plans),

(ii) section 106 (relating to contributions by employer to accident and health plans),

(iii) section 127 (relating to educational assistance programs) or would be so excludable but for section 127(d), but only to the extent paid or incurred to a person not related to the employer, or

(iv) section 129 (relating to dependent care assistance programs).

The amount treated as wages by clause (i) or (ii) for any period shall be based on the reasonable cost of coverage for the period, but shall not exceed the applicable premium for the period under section 4980B(f)(4).

(C) Special rules for agricultural and railway labor.—If such recipient is an employee to whom subparagraph (A) or (B) of section 51(h)(1) applies, rules similar to the rules of such subparagraphs shall apply except that—

(i) such subparagraph (A) shall be applied by substituting "$10,000" for "$6,000", and

(ii) such subparagraph (B) shall be applied by substituting "$833.33" for "$500".

(c) Long-Term Family Assistance Recipients.—For purposes of this section—

(1) In general.—The term "long-term family assistance recipient" means any individual who is certified by the designated local agency (as defined in section 51(d)(10))—

(A) as being a member of a family receiving assistance under a IV-A program (as defined in section 51(d)(2)(B)) for at least the 18-month period ending on the hiring date,

(B)(i) as being a member of a family receiving such assistance for 18 months beginning after the date of the enactment of this section, and

(ii) as having a hiring date which is not more than 2 years after the end of the earliest such 18-month period, or

(C)(i) as being a member of a family which ceased to be eligible after the date of the enactment of this section for such assistance by reason of any limitation imposed by Federal or State law on the maximum period such assistance is payable to a family, and

(ii) as having a hiring date which is not more than 2 years after the date of such cessation.

(2) Hiring date.—The term "hiring date" has the meaning given such term by section 51(d).

(d) Certain Rules To Apply.—

(1) In general.—Rules similar to the rules of section 52, and subsections (d)(11), (f), (g), (i) (as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997), (j), and (k) of section 51, shall apply for purposes of this section.

(2) Credit to be part of general business credit, etc.—References to section 51 in section 38(b), 280C(a), and 1396(c)(3) shall be treated as including references to this section.

(e) COORDINATION WITH WORK OPPORTUNITY CREDIT.—If a credit is allowed under this section to an employer with respect to an individual for any taxable year, then for purposes of applying section 51 to such employer, such individual shall not be treated as a member of a targeted group for such taxable year.

(f) TERMINATION.—This section shall not apply to individuals who begin work for the employer after April 30, 1999.

[CCH Explanation at ¶ 320. Committee Reports at ¶ 10,485.]

Amendment Notes

Act. Sec. 801(a) amended subpart F of part IV of subchapter A of chapter 1 by inserting after Code Sec. 51 a new Code Sec. 51A to read as above.

The above amendment applies to individuals who begin work for the employer after December 31, 1997.

[¶ 5027] CODE SEC. 52. SPECIAL RULES.

* * *

(c) TAX-EXEMPT ORGANIZATIONS.—No credit shall be allowed under section 38 for any *work opportunity credit* determined under this subpart to any organization (other than a cooperative described in section 521) which is exempt from income tax under this chapter.

* * *

Amendment Notes

Act Sec. 1601(b) amended Code Sec. 52(c) by striking "targeted jobs credit" and inserting "work opportunity credit".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for individuals who begin to work for the employer after September 30, 1996.—CCH.].

[¶ 5029] CODE SEC. 55. ALTERNATIVE MINIMUM TAX IMPOSED.

* * *

(b) TENTATIVE MINIMUM TAX.—For purposes of this part—

(1) AMOUNT OF TENTATIVE TAX.—

(A) NONCORPORATE TAXPAYERS.—

* * *

(ii) TAXABLE EXCESS.—For purposes of *this subsection*, the term "taxable excess" means so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount.

* * *

(3) MAXIMUM RATE OF TAX ON NET CAPITAL GAIN OF NONCORPORATE TAXPAYERS.—The amount determined under the first sentence of paragraph (1)(A)(i) shall not exceed the sum of—

(A) the amount determined under such first sentence computed at the rates and in the same manner as if this paragraph had not been enacted on the taxable excess reduced by the lesser of—

(i) the net capital gain, or

(ii) the sum of—

(I) the adjusted net capital gain, plus

(II) the unrecaptured section 1250 gain, plus

(B) 25 percent of the lesser of—

(i) the unrecaptured section 1250 gain, or

(ii) the amount of taxable excess in excess of the sum of—

(I) the adjusted net capital gain, plus

(II) the amount on which a tax is determined under subparagraph (A), plus

(C) 10 percent of so much of the taxpayer's adjusted net capital gain (or, if less, taxable excess) as does not exceed the amount on which a tax is determined under section 1(h)(1)(D), plus

(D) 20 percent of the taxpayer's adjusted net capital gain (or, if less, taxable excess) in excess of the amount on which tax is determined under subparagraph (C).

In the case of taxable years beginning after December 31, 2000, rules similar to the rules of section 1(h)(2) shall apply for purposes of subparagraphs (C) and (D). Terms used in this paragraph which are also used in section 1(h) shall have the respective meanings given such terms by section 1(h).

Amendment Notes

Act Sec. 311(b)(1) amended Code Sec. 55(b) by adding a new paragraph (3) to read as above.

The above amendment generally applies to tax years ending after May 6, 1997. For a special rule, see Act Sec. 311(e) following Code Sec. 1(h), above.

Act Sec. 311(b)(2)(A) amended Code Sec. 55(b)(1)(A)(ii) by striking "clause (i)" and inserting "this subsection".

The above amendment applies to tax years ending after May 6, 1997.

(c) REGULAR TAX.—

[Caution: Code Sec. 55(c)(1), below, as amended by Act Sec. 1601(b)(2)(A) of P.L. 104-188 but prior to amendment by Act Sec. 1401(b)(3) of P.L. 104-188, applies to tax years beginning after December 31, 1995, and before January 1, 2000.—CCH.]

(1) IN GENERAL.—For purposes of this section, the term "regular tax" means the regular tax liability for the taxable year (as defined in section 26(b)) reduced by the foreign tax credit allowable under section 27(a), the section 936 credit allowable under section 27(b), and the *Puerto Rico* economic activity credit under section 30A. Such terms shall not include any tax imposed by section 402(d) and shall not include any increase in tax under section 49(b) or 50(a) or subsection (j) or (k) of section 42.

[Caution: Code Sec. 55(c)(1), below, as amended by Act Secs. 1601(b)(2)(A) and 1401(b)(3) of P.L. 104-188, applies to tax years beginning after December 31, 1999.—CCH.]

(1) IN GENERAL.—For purposes of this section, the term "regular tax" means the regular tax liability for the taxable year (as defined in section 26(b)) reduced by the foreign tax credit allowable under section 27(a), the section 936 credit allowable under section 27(b), and the *Puerto Rico* economic activity credit under section 30A. Such terms shall not include any increase in tax under section 49(b) or 50(a) or subsection (j) or (k) of section 42.

* * *

Amendment Notes

Act Sec. 1601(f)(1)(C) amended Code Sec. 55(c)(1) by striking "Puerto Rican" and inserting "Puerto Rico".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [generally effective for tax years beginning after December 31, 1995.—CCH.].

(e) EXEMPTION FOR SMALL CORPORATIONS.—

(1) IN GENERAL.—The tentative minimum tax of a corporation shall be zero for any taxable year if—

(A) such corporation met the $5,000,000 gross receipts test of section 448(c) for its first taxable year beginning after December 31, 1996, and

(B) such corporation would meet such test for the taxable year and all prior taxable years beginning after such first taxable year if such test were applied by substituting "$7,500,000" for "$5,000,000".

(2) PROSPECTIVE APPLICATION OF MINIMUM TAX IF SMALL CORPORATION CEASES TO BE SMALL.—In the case of a corporation whose tentative minimum tax is zero for any prior taxable year by reason of paragraph (1), the application of this part for taxable years beginning with the first taxable year such corporation ceases to be described in paragraph (1) shall be determined with the following modifications:

(A) Section 56(a)(1) (relating to depreciation) and section 56(a)(5) (relating to pollution control facilities) shall apply only to property placed in service on or after the change date.

(B) Section 56(a)(2) (relating to mining exploration and development costs) shall apply only to costs paid or incurred on or after the change date.

(C) Section 56(a)(3) (relating to treatment of long-term contracts) shall apply only to contracts entered into on or after the change date.

(D) Section 56(a)(4) (relating to alternative net operating loss deduction) shall apply in the same manner as if, in section 56(d)(2), the change date were substituted for "January 1, 1987" and the day before the change date were substituted for "December 31, 1986" each place it appears.

(E) Section 56(g)(2)(B) (relating to limitation on allowance of negative adjustments based on adjusted current earnings) shall apply only to prior taxable years beginning on or after the change date.

(F) Section 56(g)(4)(A) (relating to adjustment for depreciation to adjusted current earnings) shall not apply.

(G) Subparagraphs (D) and (F) of section 56(g)(4) (relating to other earnings and profits adjustments and depletion) shall apply in the same manner as if the day before the change date were substituted for "December 31, 1989" each place it appears therein.

(3) EXCEPTION.—The modifications in paragraph (2) shall not apply to—

(A) any item acquired by the corporation in a transaction to which section 381 applies, and

(B) any property the basis of which in the hands of the corporation is determined by reference to the basis of the property in the hands of the transferor, if such item or property was subject to any provision referred to in paragraph (2) while held by the transferor.

(4) CHANGE DATE.—For purposes of paragraph (2), the change date is the first day of the first taxable year for which the taxpayer ceases to be described in paragraph (1).

(5) LIMITATION ON USE OF CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY.—In the case of a taxpayer whose tentative minimum tax for any taxable year is zero by reason of paragraph (1), section 53(c) shall be applied for such year by reducing the amount otherwise taken into account under section 53(c)(1) by 25 percent of so much of such amount as exceeds $25,000. Rules similar to the rules of section 38(c)(3)(B) shall apply for purposes of the preceding sentence.

[CCH Explanation at ¶ 303 and 525. Committee Reports at ¶ 10,295 and 10,335.]

Amendment Notes

Act Sec. 401(a) amended Code Sec. 55 by adding at the end a new subsection (e) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5031] CODE SEC. 56. ADJUSTMENTS IN COMPUTING ALTERNATIVE MINIMUM TAXABLE INCOME.

(a) ADJUSTMENTS APPLICABLE TO ALL TAXPAYERS.—In determining the amount of the alternative minimum taxable income for any taxable year the following treatment shall apply (in lieu of the treatment applicable for purposes of computing the regular tax):

(1) DEPRECIATION.—

(A) IN GENERAL.—

(i) PROPERTY OTHER THAN CERTAIN PERSONAL PROPERTY.—Except as provided in clause (ii), the depreciation deduction allowable under section 167 with respect to any tangible property placed in service after December 31, 1986, shall be determined under the alternative system of section 168(g). *In the case of property placed in service after December 31, 1998, the preceding sentence shall not apply but clause (ii) shall continue to apply.*

* * *

(5) POLLUTION CONTROL FACILITIES.—In the case of any certified pollution control facility placed in service after December 31, 1986, the deduction allowable under section 169 (without regard to section 291) shall be determined under the alternative system of section 168(g). *In the case of such a facility placed in service after December 31, 1998, such deduction shall be determined under section 168 using the straight line method.*

(6) ADJUSTED BASIS.—The adjusted basis of any property to which paragraph (1) or (5) applies (or with respect to which there are any expenditures to which paragraph (2) or subsection (b)(2) applies) shall be determined on the basis of the treatment prescribed in paragraph (1), (2), or (5), or subsection (b)(2), whichever applies.

(7) SECTION 87 not applicable.—Section 87 (relating to alcohol fuel credit) shall not apply.

* * *

Amendment Notes

Act Sec. 402(a) amended Code Sec. 56(a)(1)(A)(i) by adding a new sentence to read as above.

Act Sec. 402(b) amended Code Sec. 56(a)(5) by adding a new sentence to read as above.

The above amendments are effective on the date of enactment of this Act.

Act Sec. 403(a) amended Code Sec. 56(a) by striking paragraph (6) and by redesignating paragraphs (7)-(8) as paragraphs (6) and (7), respectively. Prior to being stricken, Code Sec. 56(a)(6) read as follows:

(6) INSTALLMENT SALES OF CERTAIN PROPERTY.—In the case of any disposition after March 1, 1986, of any property described in section 1221(1), income from such disposition shall be determined without regard to the installment method under section 453. This paragraph shall not apply to any disposition with respect to which an election is in effect under section 453(l)(2)(B).

The above amendment applies to dispositions in tax years beginning after December 31, 1987. For a special rule, see Act Sec. 403(b)(2), below.

Act Sec. 403(b)(2) provides:

(2) SPECIAL RULE FOR 1987.—In the case of taxable years beginning in 1987, the last sentence of section 56(a)(6) of the Internal Revenue Code of 1986 (as in effect for such taxable years) shall be applied by inserting "or in the case of a taxpayer using the cash receipts and disbursements method of accounting, any disposition described in section 453C(e)(1)(B)(ii)" after "section 453C(e)(4)".

(e) QUALIFIED HOUSING INTEREST.—For purposes of this part—

(1) IN GENERAL.—The term "qualified housing interest" means interest which is qualified residence interest (as defined in section 163(h)(3)) and is paid or accrued during the taxable year on indebtedness which is incurred in acquiring, constructing, or substantially improving any property which—

(A) is the principal residence (within the meaning of *section 121*) of the taxpayer at the time such interest accrues, or

(B) is a qualified dwelling which is a qualified residence (within the meaning of section 163(h)(4)).

Such term also includes interest on any indebtedness resulting from the refinancing of indebtedness meeting the requirements of the preceding sentence; but only to the extent that the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness immediately before the refinancing.

* * *

(3) SPECIAL RULE FOR INDEBTEDNESS INCURRED BEFORE JULY 1, 1982.—The term "qualified housing interest" includes interest which is qualified residence interest (as defined in section 163(h)(3)) and is paid or accrued on indebtedness which—

(A) was incurred by the taxpayer before July 1, 1982, and

(B) is secured by property which, at the time such indebtedness was incurred, was—

(i) the principal residence (within the meaning of *section 121*) of the taxpayer, or

(ii) a qualified dwelling used by the taxpayer (or any member of his family (within the meaning of section 267(c)(4))).

* * *

Amendment Notes

Act Sec. 312(d)(1) amended Code Sec. 56(e)(1)(A) and (3)(B)(i) by striking "section 1034" and inserting "section 121".

The above amendment applies to sales and exchanges after May 6, 1997.

(g) ADJUSTMENTS BASED ON ADJUSTED CURRENT EARNINGS.—

* * *

(4) ADJUSTMENTS.—In determining adjusted current earnings, the following adjustments shall apply:

* * *

(B) INCLUSION OF ITEMS INCLUDED FOR PURPOSES OF COMPUTING EARNINGS AND PROFITS.—

(i) IN GENERAL.—In the case of any amount which is excluded from gross income for purposes of computing alternative minimum taxable income but is taken into account in determining the amount of earnings and profits—

(I) such amount shall be included in income in the same manner as if such amount were includible in gross income for purposes of computing alternative minimum taxable income, and

(II) the amount of such income shall be reduced by any deduction which would have been allowable in computing alternative minimum taxable income if such amount were includible in gross income.

The preceding sentence shall not apply in the case of any amount excluded from gross income under section 108 (or the corresponding provisions of prior law). *In the case of any insurance company taxable under section 831(b), this clause shall not apply to any amount not described in section 834(b).*

* * *

[CCH Explanation at ¶ 129, 363, 527 and 529. Committee Reports at ¶ 10,315, 10,340, 10,345 and 12,170.]

Amendment Notes

Act Sec. 1212(a) amended Code Sec. 56(g)(4)(B)(i) by adding at the end a new sentence to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5033] CODE SEC. 57. ITEMS OF TAX PREFERENCE.

(a) GENERAL RULE.—For purposes of this part, the items of tax preference determined under this section are—

* * *

(7) EXCLUSION FOR GAINS ON SALE OF CERTAIN SMALL BUSINESS STOCK.—An amount equal to *42 percent* of the amount excluded from gross income for the taxable year under section 1202.

* * *

[CCH Explanation at ¶ 303. Committee Reports at ¶ 10,295.]

Amendment Notes

Act Sec. 311(b)(2)(B) amended Code Sec. 57(a)(7) by striking "one-half" and inserting "42 percent".

The above amendment applies to tax years ending after May 6, 1997.

[¶ 5035] CODE SEC. 59. OTHER DEFINITIONS AND SPECIAL RULES.

(a) ALTERNATIVE MINIMUM TAX FOREIGN TAX CREDIT.—For purposes of this part—

* * *

(2) LIMITATION TO 90 PERCENT OF TAX.—

* * *

(C) *[Stricken.]*

* * *

(3)[(4)] ELECTION TO USE SIMPLIFIED SECTION 904 LIMITATION.—

(A) IN GENERAL.—In determining the alternative minimum tax foreign tax credit for any taxable year to which an election under this paragraph applies—

(i) subparagraph (B) of paragraph (1) shall not apply, and

(ii) the limitation of section 904 shall be based on the proportion which—

(I) the taxpayer's taxable income (as determined for purposes of the regular tax) from sources without the United States (but not in excess of the taxpayer's entire alternative minimum taxable income), bears to

(II) the taxpayer's entire alternative minimum taxable income for the taxable year.

(B) ELECTION.—

(i) IN GENERAL.—An election under this paragraph may be made only for the taxpayer's first taxable year which begins after December 31, 1997, and for which the taxpayer claims an alternative minimum tax foreign tax credit.

(ii) ELECTION REVOCABLE ONLY WITH CONSENT.—An election under this paragraph, once made, shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

* * *

Amendment Notes

Act Sec. 1057(a) amended Code Sec. 59(a)(2) by striking subparagraph (C). Prior to being stricken, Code Sec. 59(a)(2)(C) read as follows:

(C) EXCEPTION.—Subparagraph (A) shall not apply to any domestic corporation if—

(i) more than 50 percent of the stock of such domestic corporation (by vote and value) is owned by United States persons who are not members of an affiliated group (as defined in section 1504 of such Code) which includes such corporation,

(ii) all of the activities of such corporation are conducted in 1 foreign country with which the United States has an income tax treaty in effect and such treaty provides for the exchange of information between such foreign country and the United States,

(iii) all of the current earnings and profits of such corporation are distributed at least annually (other than current earnings and profits retained for normal maintenance or capital replacements or improvements of an existing business), and

(iv) all of such distributions by such corporation to United States persons are used by such persons in a trade or business conducted in the United States.

The above amendment applies to tax years beginning after the date of the enactment of this Act.

Act Sec. 1103(a) amended Code Sec. 59(a) by adding at the end a new paragraph (3)[(4)] to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

(j) TREATMENT OF UNEARNED INCOME OF MINOR CHILDREN.—

(1) IN GENERAL.—In the case of a child to whom section 1(g) applies, the exemption amount for purposes of section 55 shall not exceed the sum of—

(A) such child's earned income (as defined in section 911(d)(2)) for the taxable year, plus

(B) $5,000.

(2) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 1998, the dollar amount in paragraph (1)(B) shall be increased by an amount equal to the product of—

(A) such dollar amount, and

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "1997" for "1992" in subparagraph (B) thereof.

If any increase determined under the preceding sentence is not a multiple of $50, such increase shall be rounded to the nearest multiple of $50.

* * *

[CCH Explanation at ¶ 185, 907 and 910. Committee Reports at ¶ 11,395, 11,625 and 12,120.]

Amendment Notes

Act Sec. 1201(b)(1) amended Code Sec. 59(j) to read as above. Prior to amendment, Code Sec. 59(j) read as follows:

(j) TREATMENT OF UNEARNED INCOME OF MINOR CHILDREN.—

(1) LIMITATION ON EXEMPTION AMOUNT.—In the case of a child to whom section 1(g) applies, the exemption amount for purposes of section 55 shall not exceed the sum of—

(A) such child's earned income (as defined in section 911(d)(2)) for the taxable year, plus

(B) twice the amount in effect for the taxable year under section 63(c)(5)(A) (or, if greater, the child's share of the unused parental minimum tax exemption).

(2) LIMITATION BASED ON PARENTAL MINIMUM TAX.—

(A) IN GENERAL.—In the case of a child to whom section 1(g) applies, the amount of the tax imposed by section 55 shall not exceed such child's share of the allocable parental minimum tax.

(B) ALLOCABLE PARENTAL MINIMUM TAX.—For purposes of this paragraph, the term "allocable parental minimum tax" means the excess of—

(i) the tax which would be imposed by section 55 on the parent if—

(I) the amount of the parent's tentative minimum tax were increased by the aggregate of the tentative minimum taxes of all children of the parent to whom section 1(g) applies and

(II) the amount of the parent's regular tax were increased by the aggregate of the regular taxes of all children of the parent to whom section 1(g) applies, over

(ii) the tax imposed by section 55 on the parent without regard to this subparagraph.

(C) CHILD SHARE.—A child's share of any allocable parental minimum tax shall be determined under rules similar to the rules of section 1(g)(3)(B).

(D) OTHER RULES MADE APPLICABLE.—For purposes of this paragraph, rules similar to the rules of paragraphs (3)(D), (5), and (6) of section 1(g) shall apply.

(3) UNUSED PARENTAL MINIMUM TAX EXEMPTION.—

(A) IN GENERAL.—For purposes of this subsection, the term "unused parental minimum tax exemption" means the excess (if any) of—

(i) the exemption amount applicable to the parent under section 55(d), over

(ii) the parent's alternative minimum taxable income.

(B) CERTAIN RULES MADE APPLICABLE.—A child's share of any unused parental minimum tax exemption shall be determined under rules similar to the rules of section 1(g)(3)(B), and rules similar to the rules of paragraphs (3)(D) and (5) of section 1(g) shall apply for purposes of this paragraph.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5037] CODE SEC. 62. ADJUSTED GROSS INCOME DEFINED.

(a) GENERAL RULE.—For purposes of this subtitle, the term "adjusted gross income" means, in the case of an individual, gross income minus the following deductions:

* * *

(2) CERTAIN TRADE AND BUSINESS DEDUCTIONS OF EMPLOYEES.—

* * *

(C) CERTAIN EXPENSES OF OFFICIALS.—The deductions allowed by section 162 which consist of expenses paid or incurred with respect to services performed by an official as an employee of a

State or a political subdivision thereof in a position compensated in whole or in part on a fee basis.

* * *

(17) INTEREST ON EDUCATION LOANS.—The deduction allowed by section 221.

[CCH Explanation at ¶ 117 and 157. Committee Reports at ¶ 10,145 and 10,920.]

Amendment Notes

Act Sec. 202(b) amended Code Sec. 62(a) by inserting after paragraph (16) a new paragraph (17) to read as above.

The above amendment applies to any qualified education loan (as defined in Code Sec. 221(e)(1), as added by Act. Sec. 202) incurred on, before, or after the date of the enactment of this Act, but only with respect to (1) any loan interest payment due and paid after December 31, 1997, and (2) the portion of the 60-month period referred to in Code Sec. 221(d) (as added by Act Sec. 202) after December 31, 1997.

Act Sec. 975(a) amended Code Sec. 62(a)(2) by adding at the end a new subparagraph (C) to read as above.

The above amendment applies to expenses paid or incurred in tax years beginning after December 31, 1986.

[¶ 5039] CODE SEC. 63. TAXABLE INCOME DEFINED.

* * *

(c) STANDARD DEDUCTION.—For purposes of this subtitle—

* * *

(4) ADJUSTMENTS FOR INFLATION.—In the case of any taxable year beginning in a calendar year after 1988, each dollar amount contained in paragraph (2) or *(5)* or subsection (f) shall be increased by an amount equal to—

(A) such dollar amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, *by substituting for "calendar year 1992" in subparagraph (B) thereof—*

(i) "calendar year 1987" in the case of the dollar amounts contained in paragraph (2) or (5)(A) or subsection (f), and

(ii) "calendar year 1997" in the case of the dollar amount contained in paragraph (5)(B).

(5) LIMITATION ON BASIC STANDARD DEDUCTION IN THE CASE OF CERTAIN DEPENDENTS.—In the case of an individual with respect to whom a deduction under section 151 is allowable to another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins, the basic standard deduction applicable to such individual for such individual's taxable year *shall not exceed the greater of—*

(A) $500, or

(B) the sum of $250 and such individual's earned income.

* * *

[CCH Explanation at ¶ 101. Committee Reports at ¶ 12,115.]

Amendment Notes

Act Sec. 1201(a)(1) amended Code Sec. 63(c)(5) by striking "shall not exceed" and all that follows and inserting "shall not exceed the greater of —(A) $500, or (B) the sum of $250 and such individual's earned income.". Prior to amendment, Code Sec. 63(c)(5) read as follows:

(5) LIMITATION ON BASIC STANDARD DEDUCTION IN THE CASE OF CERTAIN DEPENDENTS.—In the case of an individual with respect to whom a deduction under section 151 is allowable to another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins, the basic standard deduction applicable to such individual for such individual's taxable year shall not exceed the greater of—

(A) $500, or

(B) such individual's earned income.

Act Sec. 1201(a)(2)(A)-(B) amended Code Sec. 63(c)(4) by striking "(5)(A)" in the material preceding subparagraph (A) and inserting "(5)", and by striking "by substituting" and all that follows in subparagraph (B) and inserting "by substituting for 'calendar year 1992' in subparagraph (B) thereof—" and clauses (i) and (ii) to read as above. Prior to amendment, Code Sec. 63(c)(4)(B) read as follows:

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting "calendar year 1987" for "calendar year 1992 " in subparagraph (B) thereof.

The above amendments apply to tax years beginning after December 31, 1997.

[¶ 5041] CODE SEC. 72. ANNUITIES; CERTAIN PROCEEDS OF ENDOWMENT AND LIFE INSURANCE CONTRACTS.

* * *

(d) SPECIAL RULES FOR QUALIFIED EMPLOYER RETIREMENT PLANS.—

(1) SIMPLIFIED METHOD OF TAXING ANNUITY PAYMENTS.—

* * *

(B) METHOD OF RECOVERING INVESTMENT IN CONTRACT.—

* * *

(iii) NUMBER OF ANTICIPATED PAYMENTS.—*If the annuity is payable over the life of a single individual, the number of anticipated payments shall be determined as follows:*

If the age of the annuitant on the annuity starting date is:	*The number of anticipated payments is:*
Not more than 55	360
More than 55 but not more than 60	310
More than 60 but not more than 65	260
More than 65 but not more than 70	210
More than 70	160

(iv) NUMBER OF ANTICIPATED PAYMENTS WHERE MORE THAN ONE LIFE.—If the annuity is payable over the lives of more than 1 individual, the number of anticipated payments shall be determined as follows:

If the combined ages of annuitants are:	*The number is:*
Not more than 110	*410*
More than 110 but not more than 120	*360*
More than 120 but not more than 130	*310*
More than 130 but not more than 140	*260*
More than 140	*210*

* * *

Amendment Notes

Act Sec. 1075(a) amended Code Sec. 72(d)(1)(B) by adding new clause (iv) to read as above.

Act Sec. 1075(b)(1)-(2) amended Code Sec. 72(d)(1)(B)(iii) by inserting the text after the heading and before the table to read as above, and by striking "primary" in the table.

The above amendments apply with respect to annuity starting dates beginning after December 31, 1997.

(t) 10-PERCENT ADDITIONAL TAX ON EARLY DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS.—

* * *

(2) SUBSECTION NOT TO APPLY TO CERTAIN DISTRIBUTIONS.—Except as provided in paragraphs (3) and (4), paragraph (1) shall not apply to any of the following distributions:

* * *

(E) DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT PLANS FOR HIGHER EDUCATION EXPENSES.—Distributions to an individual from an individual retirement plan to the extent such distributions do not exceed the qualified higher education expenses (as defined in paragraph (7)) of the taxpayer for the taxable year. Distributions shall not be taken into account under the preceding sentence if such distributions are described in subparagraph (A), (C), or (D) or to the extent paragraph (1) does not apply to such distributions by reason of subparagraph (B).

(F) DISTRIBUTIONS FROM CERTAIN PLANS FOR FIRST HOME PURCHASES.—Distributions to an individual from an individual retirement plan which are qualified first-time homebuyer distributions (as defined in paragraph (8)). Distributions shall not be taken into account under the preceding sentence if such distributions are described in subparagraph (A), (C), (D), or (E) or to the extent paragraph (1) does not apply to such distributions by reason of subparagraph (B).

* * *

(7) QUALIFIED HIGHER EDUCATION EXPENSES.—For purposes of paragraph (2)(E)—

(A) IN GENERAL.—The term "qualified higher education expenses" means qualified higher education expenses (as defined in section 529(e)(3)) for education furnished to—

(i) the taxpayer,

(ii) the taxpayer's spouse, or

(iii) any child (as defined in section 151(c)(3)) or grandchild of the taxpayer or the taxpayer's spouse, at an eligible educational institution (as defined in section 529(e)(5)).

(B) COORDINATION WITH OTHER BENEFITS.—The amount of qualified higher education expenses for any taxable year shall be reduced as provided in section 25A(g)(2).

(8) QUALIFIED FIRST-TIME HOMEBUYER DISTRIBUTIONS.—For purposes of paragraph (2)(F)—

(A) In general.—The term "qualified first-time homebuyer distribution" means any payment or distribution received by an individual to the extent such payment or distribution is used by the individual before the close of the 120th day after the day on which such payment or distribution is received to pay qualified acquisition costs with respect to a principal residence of a first-time homebuyer who is such individual, the spouse of such individual, or any child, grandchild, or ancestor of such individual or the individual's spouse.

(B) Lifetime dollar limitation.—The aggregate amount of payments or distributions received by an individual which may be treated as qualified first-time homebuyer distributions for any taxable year shall not exceed the excess (if any) of—

(i) $10,000, over

(ii) the aggregate amounts treated as qualified first-time homebuyer distributions with respect to such individual for all prior taxable years.

(C) Qualified acquisition costs.—For purposes of this paragraph, the term "qualified acquisition costs" means the costs of acquiring, constructing, or reconstructing a residence. Such term includes any usual or reasonable settlement, financing, or other closing costs.

(D) First-time homebuyer: other definitions.—For purposes of this paragraph—

(i) First-time homebuyer.—The term "first-time homebuyer" means any individual if—

(I) such individual (and if married, such individual's spouse) had no present ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the principal residence to which this paragraph applies, and

(II) subsection (h) or (k) of section 1034 (as in effect on the day before the date of the enactment of this paragraph) did not suspend the running of any period of time specified in section 1034 (as so in effect) with respect to such individual on the day before the date the distribution is applied pursuant to subparagraph (A).

(ii) Principal residence.—The term "principal residence" has the same meaning as when used in section 121.

(iii) Date of acquisition.—The term "date of acquisition" means the date—

(I) on which a binding contract to acquire the principal residence to which subparagraph (A) applies is entered into, or

(II) on which construction or reconstruction of such a principal residence is commenced.

(E) Special rule where delay in acquisition.—If any distribution from any individual retirement plan fails to meet the requirements of subparagraph (A) solely by reason of a delay or cancellation of the purchase or construction of the residence, the amount of the distribution may be contributed to an individual retirement plan as provided in section 408(d)(3)(A)(i) (determined by substituting "120 days" for "60 days" in such section), except that—

(i) section 408(d)(3)(B) shall not be applied to such contribution, and

(ii) such amount shall not be taken into account in determining whether section 408(d)(3)(B) applies to any other amount.

* * *

[CCH Explanation at ¶ 174, 177 and 781. Committee Reports at ¶ 10,150, 10,265 and 11,485.]

Amendment Notes

Act Sec. 203(a) amended Code Sec. 72(t)(2) by adding at the end a new subparagraph (E) to read as above.

Act Sec. 203(b) amended Code Sec. 72(t) by adding at the end a new paragraph (7) to read as above.

The above amendments apply to distributions after December 31, 1997, with respect to expenses paid after such date (in tax years ending after such date), for education furnished in academic periods beginning after such date.

Act Sec. 303(a) amended Code Sec. 72(t)(2) (as amended by Act Sec. 203) by adding a new subparagraph (F) to read as above.

Act Sec. 303(b) amended Code Sec. 72(t) (as amended by Act Sec. 203) by adding a new paragraph (8) to read as above.

The above amendments apply to payments and distributions in tax years beginning after December 31, 1997.

[¶ 5043] CODE SEC. 101. CERTAIN DEATH BENEFITS.

(a) Proceeds of Life Insurance Contracts Payable by Reason of Death.—

* * *

(2) Transfer for valuable consideration.—In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance contract or any interest therein, the

amount excluded from gross income by paragraph (1) shall not exceed an amount equal to the sum of the actual value of such consideration and the premiums and other amounts subsequently paid by the transferee. The preceding sentence shall not apply in the case of such a transfer—

(A) if such contract or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferor, or

(B) if such transfer is to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer.

The term "other amounts" in the first sentence of this paragraph includes interest paid or accrued by the transferee on indebtedness with respect to such contract or any interest therein if such interest paid or accrued is not allowable as a deduction by reason of section 264(a)(4).

* * *

Amendment Notes

Act Sec. 1084(b)(2) amended Code Sec. 101(a)(2) by adding at the end a new flush sentence to read as above.

For the effective date of the above amendment, see Act Sec. 1084(d), below.

Act Sec. 1084(d) provides:

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to contracts issued after June 8, 1997, in taxable years ending after such date. For purposes of the preceding sentence, any material increase in the death benefit or other material change in the contract shall be treated as a new contract but the addition of covered lives shall be treated as a new contract only with respect to such additional covered lives. For purposes of this subsection, an increase in the death benefit under a policy or contract issued in connection with a lapse described in section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 shall not be treated as a new contract.

(h) SURVIVOR BENEFITS ATTRIBUTABLE TO SERVICE BY A PUBLIC SAFETY OFFICER WHO IS KILLED IN THE LINE OF DUTY.—

(1) IN GENERAL.—Gross income shall not include any amount paid as a survivor annuity on account of the death of a public safety officer (as such term is defined in section 1204 of the Omnibus Crime Control and Safe Streets Act of 1968) killed in the line of duty—

(A) if such annuity is provided, under a governmental plan which meets the requirements of section 401(a), to the spouse (or a former spouse) of the public safety officer or to a child of such officer; and

(B) to the extent such annuity is attributable to such officer's service as a public safety officer.

(2) EXCEPTIONS.—Paragraph (1) shall not apply with respect to the death of any public safety officer if, as determined in accordance with the provisions of the Omnibus Crime Control and Safe Streets Act of 1968—

(A) the death was caused by the intentional misconduct of the officer or by such officer's intention to bring about such officer's death;

(B) the officer was voluntarily intoxicated (as defined in section 1204 of such Act) at the time of death;

(C) the officer was performing such officer's duties in a grossly negligent manner at the time of death; or

(D) the payment is to an individual whose actions were a substantial contributing factor to the death of the officer.

* * *

[CCH Explanation at ¶ 137 and 845. Committee Reports at ¶ 11,530 and 13,415.]

Amendment Notes

Act Sec. 1528(a) amended Code Sec. 101 by adding a new subsection (h) to read as above.

The above amendment applies to amounts received in tax years beginning after December 31, 1996, with respect to individuals dying after such date.

[¶ 5045] CODE SEC. 108. INCOME FROM DISCHARGE OF INDEBTEDNESS.

* * *

(f) STUDENT LOANS.—

* * *

(2) STUDENT LOAN.—For purposes of this subsection, the term "student loan" means any loan to an individual to assist the individual in attending an educational organization described in section 170(b)(1)(A)(ii) made by—

(A) the United States, or an instrumentality or agency thereof,

(B) a State, territory, or possession of the United States, or the District of Columbia, or any political subdivision thereof,

(C) a public benefit corporation—

(i) which is exempt from taxation under section 501(c)(3),

(ii) which has assumed control over a State, county, or municipal hospital, and

(iii) whose employees have been deemed to be public employees under State law, or

(D) any educational organization described in section 170(b)(1)(A)(ii) if such loan is made—

(i) pursuant to an agreement with any entity described in subparagraph (A), (B), or (C) under which the funds from which the loan was made were provided to such educational organization, or

(ii) pursuant to a program of such educational organization which is designed to encourage its students to serve in occupations with unmet needs or in areas with unmet needs and under which the services provided by the students (or former students) are for or under the direction of a governmental unit or an organization described in section 501(c)(3) and exempt from tax under section 501(a).

The term "student loan" includes any loan made by an educational organization so described or by an organization exempt from tax under section 501(a) to refinance a loan meeting the requirements of the preceding sentence.

(3) EXCEPTION FOR DISCHARGES ON ACCOUNT OF SERVICES PERFORMED FOR CERTAIN LENDERS.—Paragraph (1) shall not apply to the discharge of a loan made by an organization described in paragraph (2)(D) (or by an organization described in paragraph (2)(E) from funds provided by an organization described in paragraph (2)(D)) if the discharge is on account of services performed for either such organization.

* * *

[CCH Explanation at ¶ 159. Committee Reports at ¶ 10,235.]

Amendment Notes

Act Sec. 225(a)(1) amended Code Sec. 108(f)(2) by striking "or" at the end of subparagraph (B) and by striking subparagraph (D) and inserting a new subparagraph (D) to read as above. Prior to amendment, Code Sec. 108(f)(2)(D) read as follows:

(D) any educational organization so described pursuant to an agreement with any entity described in subparagraph (A), (B), or (C) under which the funds from which the loan was made were provided to such educational organization.

Act Sec. 225(a)(2) amended Code Sec. 108(f) by adding a new paragraph (3) to read as above.

The above amendments apply to discharges of indebtedness after the date of the enactment of this Act.

[¶ 5047] *CODE SEC. 110. QUALIFIED LESSEE CONSTRUCTION ALLOWANCES FOR SHORT-TERM LEASES.*

(a) IN GENERAL.—Gross income of a lessee does not include any amount received in cash (or treated as a rent reduction) by a lessee from a lessor—

(1) under a short-term lease of retail space, and

(2) for the purpose of such lessee's constructing or improving qualified long-term real property for use in such lessee's trade or business at such retail space,

but only to the extent that such amount does not exceed the amount expended by the lessee for such construction or improvement.

(b) CONSISTENT TREATMENT BY LESSOR.—Qualified long-term real property constructed or improved in connection with any amount excluded from a lessee's income by reason of subsection (a) shall be treated as nonresidential real property of the lessor (including for purposes of section 168(i)(8)(B)).

(c) DEFINITIONS.—For purposes of this section—

(1) QUALIFIED LONG-TERM REAL PROPERTY.—The term "qualified long-term real property" means nonresidential real property which is part of, or otherwise present at, the retail space referred to in subsection (a) and which reverts to the lessor at the termination of the lease.

(2) SHORT-TERM LEASE.—The term "short-term lease" means a lease (or other agreement for occupancy or use) of retail space for 15 years or less (as determined under the rules of section 168(i)(3)).

(3) RETAIL SPACE.—The term "retail space" means real property leased, occupied, or otherwise used by a lessee in its trade or business of selling tangible personal property or services to the general public.

(d) Information Required To Be Furnished to Secretary.—Under regulations, the lessee and lessor described in subsection (a) shall, at such times and in such manner as may be provided in such regulations, furnish to the Secretary—

(1) information concerning the amounts received (or treated as a rent reduction) and expended as described in subsection (a), and

(2) any other information which the Secretary deems necessary to carry out the provisions of this section.

* * *

[CCH Explanation at ¶ 322. Committee Reports at ¶ 12,175.]

Amendment Notes

Act Sec. 1213(a) amended part III of subchapter B of chapter 1 by inserting after Code Sec. 109 a new Code Sec. 110 to read as above.

The above amendment applies to leases entered into after the date of the enactment of this Act.

[¶ 5049] *CODE SEC. 121. EXCLUSION OF GAIN FROM SALE OF PRINCIPAL RESIDENCE.*

(a) Exclusion.—Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more.

(b) Limitations.—

(1) In general.—The amount of gain excluded from gross income under subsection (a) with respect to any sale or exchange shall not exceed $250,000.

(2) $500,000 limitation for certain joint returns.—Paragraph (1) shall be applied by substituting "$500,000" for "$250,000" if—

(A) a husband and wife make a joint return for the taxable year of the sale or exchange of the property,

(B) either spouse meets the ownership requirements of subsection (a) with respect to such property,

(C) both spouses meet the use requirements of subsection (a) with respect to such property, and

(D) neither spouse is ineligible for the benefits of subsection (a) with respect to such property by reason of paragraph (3).

(3) Application to only 1 sale or exchange every 2 years.—

(A) In general.—Subsection (a) shall not apply to any sale or exchange by the taxpayer if, during the 2-year period ending on the date of such sale or exchange, there was any other sale or exchange by the taxpayer to which subsection (a) applied.

(B) Pre-May 7, 1997, sales not taken into account.—Subparagraph (A) shall be applied without regard to any sale or exchange before May 7, 1997.

(c) Exclusion for Taxpayers Failing To Meet Certain Requirements.—

(1) In general.—In the case of a sale or exchange to which this subsection applies, the ownership and use requirements of subsection (a) shall not apply and subsection (b)(3) shall not apply; but the amount of gain excluded from gross income under subsection (a) with respect to such sale or exchange shall not exceed—

(A) the amount which bears the same ratio to the amount which would be so excluded under this section if such requirements had been met, as

(B) the shorter of—

(i) the aggregate periods, during the 5-year period ending on the date of such sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence, or

(ii) the period after the date of the most recent prior sale or exchange by the taxpayer to which subsection (a) applied and before the date of such sale or exchange,

bears to 2 years.

(2) Sales and exchanges to which subsection applies.—This subsection shall apply to any sale or exchange if—

(A) subsection (a) would not (but for this subsection) apply to such sale or exchange by reason of—

(i) a failure to meet the ownership and use requirements of subsection (a), or

(ii) subsection (b)(3), and

(B) such sale or exchange is by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances.

(d) SPECIAL RULES.—

(1) JOINT RETURNS.—If a husband and wife make a joint return for the taxable year of the sale or exchange of the property, subsections (a) and (c) shall apply if either spouse meets the ownership and use requirements of subsection (a) with respect to such property.

(2) PROPERTY OF DECEASED SPOUSE.—For purposes of this section, in the case of an unmarried individual whose spouse is deceased on the date of the sale or exchange of property, the period such unmarried individual owned and used such property shall include the period such deceased spouse owned and used such property before death.

(3) PROPERTY OWNED BY SPOUSE OR FORMER SPOUSE.—For purposes of this section—

(A) PROPERTY TRANSFERRED TO INDIVIDUAL FROM SPOUSE OR FORMER SPOUSE.—In the case of an individual holding property transferred to such individual in a transaction described in section 1041(a), the period such individual owns such property shall include the period the transferor owned the property.

(B) PROPERTY USED BY FORMER SPOUSE PURSUANT TO DIVORCE DECREE, ETC.—Solely for purposes of this section, an individual shall be treated as using property as such individual's principal residence during any period of ownership while such individual's spouse or former spouse is granted use of the property under a divorce or separation instrument (as defined in section 71(b)(2)).

(4) TENANT-STOCKHOLDER IN COOPERATIVE HOUSING CORPORATION.—For purposes of this section, if the taxpayer holds stock as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as defined in such section), then—

(A) the holding requirements of subsection (a) shall be applied to the holding of such stock, and

(B) the use requirements of subsection (a) shall be applied to the house or apartment which the taxpayer was entitled to occupy as such stockholder.

(5) INVOLUNTARY CONVERSIONS.—

(A) IN GENERAL.—For purposes of this section, the destruction, theft, seizure, requisition, or condemnation of property shall be treated as the sale of such property.

(B) APPLICATION OF SECTION 1033.—In applying section 1033 (relating to involuntary conversions), the amount realized from the sale or exchange of property shall be treated as being the amount determined without regard to this section, reduced by the amount of gain not included in gross income pursuant to this section.

(C) PROPERTY ACQUIRED AFTER INVOLUNTARY CONVERSION.—If the basis of the property sold or exchanged is determined (in whole or in part) under section 1033(b) (relating to basis of property acquired through involuntary conversion), then the holding and use by the taxpayer of the converted property shall be treated as holding and use by the taxpayer of the property sold or exchanged.

(6) RECOGNITION OF GAIN ATTRIBUTABLE TO DEPRECIATION.—Subsection (a) shall not apply to so much of the gain from the sale of any property as does not exceed the portion of the depreciation adjustments (as defined in section 1250(b)(3)) attributable to periods after May 6, 1997, in respect of such property.

(7) DETERMINATION OF USE DURING PERIODS OF OUT-OF-RESIDENCE CARE.—In the case of a taxpayer who—

(A) becomes physically or mentally incapable of self-care, and

(B) owns property and uses such property as the taxpayer's principal residence during the 5-year period described in subsection (a) for periods aggregating at least 1 year, then the taxpayer shall be treated as using such property as the taxpayer's principal residence during any time during such 5-year period in which the taxpayer owns the property and resides in any facility (including a nursing home) licensed by a State or political subdivision to care for an individual in the taxpayer's condition.

(8) SALES OF REMAINDER INTERESTS.—For purposes of this section—

(A) IN GENERAL.—At the election of the taxpayer, this section shall not fail to apply to the sale or exchange of an interest in a principal residence by reason of such interest being a remainder interest in such residence, but this section shall not apply to any other interest in such residence which is sold or exchanged separately.

(B) EXCEPTION FOR SALES TO RELATED PARTIES.—Subparagraph (A) shall not apply to any sale to, or exchange with, any person who bears a relationship to the taxpayer which is described in section 267(b) or 707(b).

(e) DENIAL OF EXCLUSION FOR EXPATRIATES.—This section shall not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) applies to such individual.

(f) ELECTION TO HAVE SECTION NOT APPLY.—This section shall not apply to any sale or exchange with respect to which the taxpayer elects not to have this section apply.

(g) RESIDENCES ACQUIRED IN ROLLOVERS UNDER SECTION 1034.—For purposes of this section, in the case of property the acquisition of which by the taxpayer resulted under section 1034 (as in effect on the day before the date of the enactment of this section) in the nonrecognition of any part of the gain realized on the sale or exchange of another residence, in determining the period for which the taxpayer has owned and used such property as the taxpayer's principal residence, there shall be included the aggregate periods for which such other residence (and each prior residence taken into account under section 1223(7) in determining the holding period of such property) had been so owned and used.

* * *

[CCH Explanation at ¶ 129. Committee Reports at ¶ 10,315.]

Amendment Notes

Act Sec. 312(a) amended Code Sec. 121 to read as above. Prior to amendment, Code Sec. 121 read as follows:

SEC. 121. ONE-TIME EXCLUSION OF GAIN FROM SALE OF PRINCIPAL RESIDENCE BY INDIVIDUAL WHO HAS ATTAINED AGE 55.

(a) GENERAL RULE.—At the election of the taxpayer, gross income does not include gain from the sale or exchange of property if—

(1) the taxpayer has attained the age of 55 before the date of such sale or exchange, and

(2) during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as his principal residence for periods aggregating 3 years or more.

(b) LIMITATIONS.—

(1) DOLLAR LIMITATION.—The amount of the gain excluded from gross income under subsection (a) shall not exceed $125,000 ($62,500 in the case of a separate return by a married individual).

(2) APPLICATION TO ONLY ONE SALE OR EXCHANGE.—Subsection (a) shall not apply to any sale or exchange by the taxpayer if an election by the taxpayer or his spouse under subsection (a) with respect to any other sale or exchange is in effect.

(3) ADDITIONAL ELECTION IF PRIOR SALE WAS MADE ON OR BEFORE JULY 26, 1978.—In the case of any sale or exchange after July 26, 1978, this section shall be applied by not taking into account any election made with respect to a sale or exchange on or before such date.

(c) ELECTION.—An election under subsection (a) may be made or revoked at any time before the expiration of the period for making a claim for credit or refund of the tax imposed by this chapter for the taxable year in which the sale or exchange occurred, and shall be made or revoked in such manner as the Secretary shall by regulations prescribe. In the case of a taxpayer who is married, an election under subsection (a) or a revocation thereof may be made only if his spouse joins in such election or revocation.

(d) SPECIAL RULES.—

(1) PROPERTY HELD JOINTLY BY HUSBAND AND WIFE.—For purposes of this section, if—

(A) property is held by a husband and wife as joint tenants, tenants by the entirety, or community property,

(B) such husband and wife make a joint return under section 6013 for the taxable year of the sale or exchange, and

(C) one spouse satisfies the age, holding, and use requirements of subsection (a) with respect to such property,

then both husband and wife shall be treated as satisfying the age, holding, and use requirements of subsection (a) with respect to such property.

(2) PROPERTY OF DECEASED SPOUSE.—For purposes of this section, in the case of an unmarried individual whose spouse is deceased on the date of the sale or exchange of property, if—

(A) the deceased spouse (during the 5-year period ending on the date of the sale or exchange) satisfied the holding and use requirements of subsection (a)(2) with respect to such property, and

(B) no election by the deceased spouse under subsection (a) is in effect with respect to a prior sale or exchange,

then such individual shall be treated as satisfying the holding and use requirements of subsection (a)(2) with respect to such property.

(3) TENANT-STOCKHOLDER IN COOPERATIVE HOUSING CORPORATION.—For purposes of this section, if the taxpayer holds stock as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as defined in such section), then—

(A) the holding requirements of subsection (a)(2) shall be applied to the holding of such stock, and

(B) the use requirements of subsection (a)(2) shall be applied to the house or apartment which the taxpayer was entitled to occupy as such stockholder.

(4) INVOLUNTARY CONVERSIONS.—For purposes of this section, the destruction, theft, seizure, requisition, or condemnation of property shall be treated as the sale of such property.

(5) PROPERTY USED IN PART AS PRINCIPAL RESIDENCE.—In the case of property only a portion of which, during the 5-year period ending on the date of the sale or exchange, has been owned and used by the taxpayer as his principal residence for periods aggregating 3 years or more, this section shall apply with respect to so much of the gain from the sale or exchange of such property as is determined, under regulations prescribed by the Secretary, to be attributable to the portion of the property so owned and used by the taxpayer.

(6) DETERMINATION OF MARITAL STATUS.—In the case of any sale or exchange, for purposes of this section—

(A) the determination of whether an individual is married shall be made as of the date of the sale or exchange; and

(B) an individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

(7) APPLICATION OF sections 1033 and 1034S1034.—In applying sections 1033 (relating to involuntary conversions) and 1034 (relating to sale or exchange of residence), the amount realized from the sale or exchange of property shall be treated as being the amount determined without regard to this section, reduced by the amount of gain not included in gross income pursuant to an election under this section.

(8) PROPERTY ACQUIRED AFTER INVOLUNTARY CONVERSION.—If the basis of the property sold or exchanged is determined (in whole or in part) under subsection (b) of section 1033 (relating to basis of property acquired through involuntary conversion), then the holding and use by the taxpayer of the converted property shall be treated as holding and use by the taxpayer of the property sold or exchanged.

(9) DETERMINATION OF USE DURING PERIODS OF OUT-OF-RESIDENCE CARE.—In the case of a taxpayer who—

(A) becomes physically or mentally incapable of self-care, and

(B) owns property and uses such property as the taxpayer's principal residence during the 5-year period described in subsection (a)(2) for periods aggregating at least 1 year, then the taxpayer shall be treated as using such property as the taxpayer's principal residence during any time during such 5-year period in which the taxpayer owns the property and resides in any facility (including a nursing home) licensed by a State or political subdivision to care for an individual in the taxpayer's condition.

The above amendment generally applies to sales and exchanges after May 6, 1997. For special rules, see Act Sec. 312(d)[(e)](2)-(4), below.

Act Sec. 312(d)[(e)](2)-(4) provides:

(2) SALES BEFORE DATE OF ENACTMENT.—At the election of the taxpayer, the amendments made by this section shall not apply to any sale or exchange before the date of the enactment of this Act.

(3) CERTAIN SALES WITHIN 2 YEARS AFTER DATE OF ENACTMENT.—Section 121 of the Internal Revenue Code of 1986 (as amended by this section) shall be applied without regard to subsection (c)(2)(B) thereof in the case of any sale or exchange of property during the 2-year period beginning on the date of the enactment of this Act if the taxpayer held such property on the date of the enactment of this Act and fails to meet the ownership and use requirements of subsection (a) thereof with respect to such property.

(4) BINDING CONTRACTS.—At the election of the taxpayer, the amendments made by this section shall not apply to a sale or exchange after the date of the enactment of this Act, if—

(A) such sale or exchange is pursuant to a contract which was binding on such date, or

(B) without regard to such amendments, gain would not be recognized under section 1034 of the Internal Revenue Code of 1986 (as in effect on the day before the date of the enactment of this Act) on such sale or exchange by reason of a new residence acquired on or before such date or with respect to the acquisition of which by the taxpayer a binding contract was in effect on such date.

This paragraph shall not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) of the Internal Revenue Code of 1986 applies to such individual.

[¶ 5051] CODE SEC. 127. EDUCATIONAL ASSISTANCE PROGRAMS.

* * *

(d) TERMINATION.—This section shall not apply to expenses paid with respect to courses beginning after May 31, 2000.

* * *

[CCH Explanation at ¶ 156. Committee Reports at ¶ 10,215.]

Amendment Notes

Act Sec. 221(a) amended Code Sec. 127(d) to read as above. Prior to amendment, Code Sec. 127(d) read as follows:

(d) TERMINATION.—This section shall not apply to taxable years beginning after May 31, 1997. In the case of any taxable year beginning in 1997, only expenses paid with respect to courses beginning before July 1, 1997, shall be taken into account in determining the amount excluded under this section.

The above amendment applies to tax years beginning after December 31, 1996.

[¶ 5053] CODE SEC. 130. CERTAIN PERSONAL INJURY LIABILITY ASSIGNMENTS.

* * *

(c) QUALIFIED ASSIGNMENT.—For purposes of this section, the term "qualified assignment" means any assignment of a liability to make periodic payments as damages (whether by suit or agreement), *or as compensation under any workmen's compensation act,* on account of personal injury or sickness (in a case involving physical injury or physical sickness)—

(1) if the assignee assumes such liability from a person who is a party to the suit or agreement, *or the workmen's compensation claim,* and

(2) if—

(A) such periodic payments are fixed and determinable as to amount and time of payment,

(B) such periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of such payments,

(C) the assignee's obligation on account of the personal injuries or sickness is no greater than the obligation of the person who assigned the liability, and

(D) such periodic payments are excludable from the gross income of the recipient under *paragraph (1) or (2) of section 104(a).*

The determination for purposes of this chapter of when the recipient is treated as having received any payment with respect to which there has been a qualified assignment shall be made without regard to any provision of such assignment which grants the recipient rights as a creditor greater than those of a general creditor.

* * *

[CCH Explanation at ¶ 347. Committee Reports at ¶ 10,840.]

Amendment Notes

Act Sec. 962(a)(1)-(3) amended Code Sec. 130(c) by inserting ", or as compensation under any workmen's compensation act," after "(whether by suit or agreement)" in the material preceding paragraph (1), by inserting "or the workmen's compensation claim," after "agreement," in paragraph (1), and by striking "section 104(a)(2)" in paragraph (2)(D) and inserting "paragraph (1) or (2) of section 104(a)".

The above amendment applies to claims under workmen's compensation acts filed after the date of the enactment of this Act.

[¶ 5055] CODE SEC. 132. CERTAIN FRINGE BENEFITS.

* * *

(e) DE MINIMIS FRINGE DEFINED.—For purposes of this section—

* * *

(2) TREATMENT OF CERTAIN EATING FACILITIES.—The operation by an employer of any eating facility for employees shall be treated as a de minimis fringe if—

(A) such facility is located on or near the business premises of the employer, and

(B) revenue derived from such facility normally equals or exceeds the direct operating costs of such facility.

The preceding sentence shall apply with respect to any highly compensated employee only if access to the facility is available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of highly compensated employees. *For purposes of subparagraph (B), an employee entitled under section 119 to exclude the value of a meal provided at such facility shall be treated as having paid an amount for such meal equal to the direct operating costs of the facility attributable to such meal.*

Amendment Notes

Act Sec. 970(a) amended Code Sec. 132(e)(2) by adding at the end a new sentence to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

(f) QUALIFIED TRANSPORTATION FRINGE.—

* * *

(4) BENEFIT NOT IN LIEU OF COMPENSATION.—Subsection (a)(5) shall not apply to any qualified transportation fringe unless such benefit is provided in addition to (and not in lieu of) any compensation otherwise payable to the employee. *This paragraph shall not apply to any qualified parking provided in lieu of compensation which otherwise would have been includible in gross income of the employee, and no amount shall be included in the gross income of the employee solely because the employee may choose between the qualified parking and compensation.*

* * *

[CCH Explanation at ¶ 131 and 332. Committee Reports at ¶ 10,880 and 11,455.]

Amendment Notes

Act Sec. 1072(a) amended Code Sec. 132(f)(4) by adding at the end a new sentence to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5057] CODE SEC. 135. INCOME FROM UNITED STATES SAVINGS BONDS USED TO PAY HIGHER EDUCATION TUITION AND FEES.

* * *

(c) DEFINITIONS.—For purposes of this section—

* * *

(2) QUALIFIED HIGHER EDUCATION EXPENSES.—

* * *

(C) CONTRIBUTIONS TO QUALIFIED STATE TUITION PROGRAM.—Such term shall include any contribution to a qualified State tuition program (as defined in section 529) on behalf of a designated beneficiary (as defined in such section), or to an education individual retirement account (as defined in section 530) on behalf of an account beneficiary, who is an individual described in

subparagraph (A); but there shall be no increase in the investment in the contract for purposes of applying section 529(c)(3)(A) by reason of any portion of such contribution which is not includible in gross income by reason of this subparagraph.

* * *

Amendment Notes

Act Sec. 211(c) amended Code Sec. 135(c)(2) by adding a new subparagraph (C) to read as above.

Act Sec. 213(e)(2) amended Code Sec. 135(c)(2)(C), as added by Act Sec. 211(c), by inserting ", or to an education individual retirement account (as defined in section 530) on behalf of an account beneficiary," after "(as defined in such section)".

The above amendments apply to tax years beginning after December 31, 1997.

(d) SPECIAL RULES.—

* * *

(2) COORDINATION WITH HIGHER EDUCATION CREDIT.—The amount of the qualified higher education expenses otherwise taken into account under subsection (a) with respect to the education of an individual shall be reduced (before the application of subsection (b)) by the amount of such expenses which are taken into account in determining the credit allowable to the taxpayer or any other person under section 25A with respect to such expenses.

(3) NO EXCLUSION FOR MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—If the taxpayer is a married individual (within the meaning of section 7703), this section shall apply only if the taxpayer and his spouse file a joint return for the taxable year.

(4) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary or appropriate to carry out this section, including regulations requiring record keeping and information reporting.

* * *

[CCH Explanation at ¶ 139, 145 and 149. Committee Reports at ¶ 10,135, 10,175 and 10,185.]

Amendment Notes

Act Sec. 201(d) amended Code Sec. 135(d) by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively, and by inserting after paragraph (1) a new paragraph (2) to read as above.

The above amendment applies to expenses paid after December 31, 1997 (in tax years ending after such date), for education furnished in academic periods beginning after such date.

[¶ 5059] CODE SEC. 137. ADOPTION ASSISTANCE PROGRAMS.

* * *

(b) LIMITATIONS.—

(1) DOLLAR LIMITATION.—The aggregate *of the amounts paid or expenses incurred which may be taken into account* under subsection (a) for all taxable years with respect to the adoption of a child by the taxpayer shall not exceed $5,000 ($6,000, in the case of a child with special needs).

* * *

[CCH Explanation at ¶ 125. Committee Reports at ¶ 13,695.]

Amendment Notes

Act Sec. 1601(h)(2)(C) amended Code Sec. 137(b)(1) by striking "amount excludable from gross income" and inserting "of the amounts paid or expenses incurred which may be taken into account".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

[*Caution: Code Sec. 138, below, as added by Act Sec. 4006(a) of the Balanced Budget Act of 1997, applies to tax years beginning after December 31, 1998.—CCH.*]

[¶ 5060] *CODE SEC. 138. MEDICARE+CHOICE MSA.*

(a) EXCLUSION.—Gross income shall not include any payment to the Medicare+Choice MSA of an individual by the Secretary of Health and Human Services under part C of title XVIII of the Social Security Act.

(b) MEDICARE+CHOICE MSA.—For purposes of this section, the term "Medicare+Choice MSA" means a medical savings account (as defined in section 220(d))—

(1) which is designated as a Medicare+Choice MSA,

(2) with respect to which no contribution may be made other than—

(A) a contribution made by the Secretary of Health and Human Services pursuant to part C of title XVIII of the Social Security Act, or

(B) a trustee-to-trustee transfer described in subsection (c)(4),

(3) the governing instrument of which provides that trustee-to-trustee transfers described in subsection (c)(4) may be made to and from such account, and

(4) which is established in connection with an MSA plan described in section 1859(b)(3) of the Social Security Act.

(c) SPECIAL RULES FOR DISTRIBUTIONS.—

(1) DISTRIBUTIONS FOR QUALIFIED MEDICAL EXPENSES.—In applying section 220 to a Medicare+Choice MSA—

(A) qualified medical expenses shall not include amounts paid for medical care for any individual other than the account holder, and

(B) section 220(d)(2)(C) shall not apply.

(2) PENALTY FOR DISTRIBUTIONS FROM MEDICARE+CHOICE MSA NOT USED FOR QUALIFIED MEDICAL EXPENSES IF MINIMUM BALANCE NOT MAINTAINED.—

(A) IN GENERAL.—The tax imposed by this chapter for any taxable year in which there is a payment or distribution from a Medicare+Choice MSA which is not used exclusively to pay the qualified medical expenses of the account holder shall be increased by 50 percent of the excess (if any) of—

(i) the amount of such payment or distribution, over

(ii) the excess (if any) of—

(I) the fair market value of the assets in such MSA as of the close of the calendar year preceding the calendar year in which the taxable year begins, over

(II) an amount equal to 60 percent of the deductible under the Medicare+Choice MSA plan covering the account holder as of January 1 of the calendar year in which the taxable year begins.

Section 220(f)(4) shall not apply to any payment or distribution from a Medicare+Choice MSA.

(B) EXCEPTIONS.—Subparagraph (A) shall not apply if the payment or distribution is made on or after the date the account holder—

(i) becomes disabled within the meaning of section 72(m)(7), or

(ii) dies.

(C) SPECIAL RULES.—For purposes of subparagraph (A)—

(i) all Medicare+Choice MSAs of the account holder shall be treated as 1 account,

(ii) all payments and distributions not used exclusively to pay the qualified medical expenses of the account holder during any taxable year shall be treated as 1 distribution, and

(iii) any distribution of property shall be taken into account at its fair market value on the date of the distribution.

(3) WITHDRAWAL OF ERRONEOUS CONTRIBUTIONS.—Section 220(f)(2) and paragraph (2) of this subsection shall not apply to any payment or distribution from a Medicare+Choice MSA to the Secretary of Health and Human Services of an erroneous contribution to such MSA and of the net income attributable to such contribution.

(4) TRUSTEE-TO-TRUSTEE TRANSFERS.—Section 220(f)(2) and paragraph (2) of this subsection shall not apply to any trustee-to-trustee transfer from a Medicare+Choice MSA of an account holder to another Medicare+Choice MSA of such account holder.

(d) SPECIAL RULES FOR TREATMENT OF ACCOUNT AFTER DEATH OF ACCOUNT HOLDER.—In applying section 220(f)(8)(A) to an account which was a Medicare+Choice MSA of a decedent, the rules of section 220(f) shall apply in lieu of the rules of subsection (c) of this section with respect to the spouse as the account holder of such Medicare+Choice MSA.

(e) REPORTS.—In the case of a Medicare+Choice MSA, the report under section 220(h)—

(1) shall include the fair market value of the assets in such Medicare+Choice MSA as of the close of each calendar year, and

(2) shall be furnished to the account holder—

(A) not later than January 31 of the calendar year following the calendar year to which such reports relate, and

(B) in such manner as the Secretary prescribes in such regulations.

(f) COORDINATION WITH LIMITATION ON NUMBER OF TAXPAYERS HAVING MEDICAL SAVINGS ACCOUNTS.—Subsection (i) of section 220 shall not apply to an individual with respect to a Medicare+Choice MSA, and Medicare+Choice MSA's shall not be taken into account in determining whether the numerical limitations under section 220(j) are exceeded.

[CCH Explanation at ¶ 817, 819, 821, 823, 825, 827, 829 and 831. Committee Reports at ¶ 20,015.]

Amendment Notes

Balanced Budget Act

Act Sec. 4006(a) amended part III of subchapter B of chapter 1 by redesignating Code Sec. 138 as Code Sec. 139 and by inserting after Code Sec. 137 a new Code Sec. 138 to read as above.

The above amendment applies to tax years beginning after December 31, 1998.

[*Caution: Code Sec. 139, below, as redesignated by Act Sec. 4006(a) of the Balanced Budget Act of 1997, applies to tax years beginning after December 31, 1998.—CCH.*]

[¶ 5060A] CODE SEC. *139*. CROSS REFERENCES TO OTHER ACTS.

* * *

[CCH Explanation at ¶ 817, 819, 821, 823, 825, 827, 829 and 831. Committee Reports at ¶ 20,015.]

Amendment Notes

Balanced Budget Act

Act Sec. 4006(a) amended part III of subchapter B of chapter 1 by redesignating Code Sec. 138 as Code Sec. 139.

The above amendment applies to tax years beginning after December 31, 1998.

[¶ 5061] CODE SEC. 143. MORTGAGE REVENUE BONDS: QUALIFIED MORTGAGE BOND AND QUALIFIED VETERANS' MORTGAGE BOND.

* * *

(i) OTHER REQUIREMENTS.—

(1) MORTGAGES MUST BE NEW MORTGAGES.—

* * *

(C) EXCEPTION FOR CERTAIN CONTRACT FOR DEED AGREEMENTS.—

(i) IN GENERAL.—In the case of land possessed under a contract for deed by a mortgagor—

(I) whose principal residence (within the meaning of *section 121*) is located on such land, and

(II) whose family income (as defined in subsection (f)(2)) is not more than 50 percent of applicable median family income (as defined in subsection (f)(4)),

the contract for deed shall not be treated as an existing mortgage for purposes of subparagraph (A).

* * *

Amendment Notes

Act Sec. 312(d)(1) amended Code Sec. 143(i)(1)(C)(i)(I) by striking "section 1034" and inserting "section 121".

The above amendment generally applies to sales and exchanges after May 6, 1997.

(k) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

* * *

(11) SPECIAL RULES FOR RESIDENCES LOCATED IN DISASTER AREAS.—In the case of a residence located in an area determined by the President to warrant assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (as in effect on the date of the enactment of the Taxpayer Relief Act of 1997), this section shall be applied with the following modifications to financing provided with respect to such residence within 2 years after the date of the disaster declaration:

(A) Subsection (d) (relating to 3-year requirement) shall not apply.

(B) Subsections (e) and (f) (relating to purchase price requirement and income requirement) shall be applied as if such residence were a targeted area residence.

The preceding sentence shall apply only with respect to bonds issued after December 31, 1996, and before January 1, 1999.

* * *

Amendment Notes

Act Sec. 914 amended Code Sec. 143(k) by adding at the end a new paragraph (11) to read as above.

The above amendment is effective on the date of the enactment of this Act.

(m) RECAPTURE OF PORTION OF FEDERAL SUBSIDY FROM USE OF QUALIFIED MORTGAGE BONDS AND MORTGAGE CREDIT CERTIFICATES.—

* * *

(6) SPECIAL RULES RELATING TO LIMITATION ON RECAPTURE AMOUNT BASED ON GAIN REALIZED.—

(A) IN GENERAL.—For purposes of paragraph (1), gain shall be taken into account whether or not recognized, and the adjusted basis of the taxpayer's interest in the residence shall be determined without regard to sections 1033(b) and 1034(e) *(as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997)* for purposes of determining gain.

* * *

[CCH Explanation at ¶ 129 and 349. Committee Reports at ¶ 10,315 and 10,615.]

Amendment Notes

Act Sec. 312(d)(3) amended Code Sec. 143(m)(6)(A) by inserting "(as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997)" after "1034(e)".

The above amendment generally applies to sales and exchanges after May 6, 1997.

[¶ 5063] CODE SEC. 145. QUALIFIED 501(c)(3) BOND.

* * *

(b) $150,000,000 LIMITATION ON BONDS OTHER THAN HOSPITAL BONDS.—

* * *

(5) TERMINATION OF LIMITATION.—This subsection shall not apply with respect to bonds issued after the date of the enactment of this paragraph as part of an issue 95 percent or more of the net proceeds of which are to be used to finance capital expenditures incurred after such date.

* * *

[CCH Explanation at ¶ 353. Committee Reports at ¶ 10,220.]

Amendment Notes

Act Sec. 222 amended Code Sec. 145(b) by adding at the end a new paragraph (5) to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5065] CODE SEC. 148. ARBITRAGE.

* * *

(c) TEMPORARY PERIOD EXCEPTION.—

* * *

(2) LIMITATION ON TEMPORARY PERIOD FOR POOLED FINANCINGS.—

* * *

(B) SHORTER TEMPORARY PERIOD FOR LOAN REPAYMENTS, ETC.—Subparagraph (A) shall be applied by substituting "3 months" for "6 months" with respect to the proceeds from the sale or repayment of any loan which are to be used to make or finance any loan. For purposes of the preceding sentence, a nonpurpose investment shall not be treated as a loan.

(C) BONDS USED TO PROVIDE CONSTRUCTION FINANCING.—In the case of an issue described in subparagraph (A) any portion of which is used to make or finance loans for construction expenditures (within the meaning of subsection (f)(4)(C)(iv)—

(i) rules similar to the rules of subsection (f)(4)(C)(v) shall apply, and

(ii) subparagraph (A) shall be applied with respect to such portion by substituting "2 years" for "6 months".

(D) EXCEPTION FOR MORTGAGE REVENUE BONDS.—This paragraph shall not apply to any qualified mortgage bond or qualified veterans' mortgage bond.

Amendment Notes

Act Sec. 1444(a) amended Code Sec. 148(c)(2) by striking subparagraph (B) and by redesignating subparagraphs (C), (D), and (E) as subparagraphs (B), (C), and (D), respectively. Prior to being stricken, Code Sec. 148(c)(2)(B) read as follows:

(B) SPECIAL RULE FOR CERTAIN STUDENT LOAN POOLS.—In the case of the proceeds of an issue to be used to make or finance loans under a program described in section 144(b)(1)(A), subparagraph (A) shall be applied by substituting "18 months" for "6 months". The preceding sentence shall not apply to any bond issued after December 31, 1988.

The above amendment applies to bonds issued after the date of the enactment of this Act.

(d) SPECIAL RULES FOR REASONABLY REQUIRED RESERVE OR REPLACEMENT FUND.—

* * *

(3) *[Stricken.]*

* * *

Amendment Notes

Act Sec. 1443 amended Code Sec. 148(d) by striking paragraph (3). Prior to being stricken, Code Sec. 148(d)(3) read as follows:

(3) LIMITATION ON INVESTMENT IN NONPURPOSE INVESTMENTS.—

(A) IN GENERAL.—A bond which is part of an issue which does not meet the requirements of subparagraph (B) shall be treated as an arbitrage bond.

(B) REQUIREMENTS.—An issue meets the requirements of this subparagraph only if—

(i) at no time during any bond year may the amount invested in nonpurpose investments with a yield materially higher than the yield on the issue exceed 150 percent of the debt service on the issue for the bond year, and

(ii) the aggregate amount invested as provided in clause (i) is promptly and appropriately reduced as the amount of outstanding bonds of the issue is reduced (or, in the case of a qualified mortgage bond or a qualified veterans' mortgage bond, as the mortgages are repaid).

(C) EXCEPTIONS FOR TEMPORARY PERIOD.—Subparagraph (B) shall not apply to—

(i) proceeds of the issue invested for an initial temporary period until such proceeds are needed for the governmental purpose of the issue, and

(ii) temporary investment periods related to debt service.

(D) DEBT SERVICE DEFINED.—For purposes of this paragraph, the debt service on the issue for any bond year is the scheduled amount of interest and amortization of principal payable for such year with respect to such issue. For purposes of the preceding sentence, there shall not be taken into account amounts scheduled with respect to any bond which has been redeemed before the beginning of the bond year.

(E) NO DISPOSITION IN CASE OF LOSS.—This paragraph shall not require the sale or disposition of any investment if such sale or disposition would result in a loss which exceeds the amount which, but for such sale or disposition, would at the time of such sale or disposition—

(i) be paid to the United States, or,

(ii) in the case of a qualified veterans' mortgage bond, be paid or credited mortgagors under section 143(g)(3)(A).

(F) EXCEPTION FOR GOVERNMENTAL USE BONDS AND QUALIFIED 501(C)(3) BONDS.—This paragraph shall not apply to any bond which is not a private activity bond or which is a qualified 501(c)(3) bond.

The above amendment applies to bonds issued after the date of the enactment of this Act.

(f) REQUIRED REBATE TO THE UNITED STATES.—

* * *

(4) SPECIAL RULES FOR APPLYING PARAGRAPH (2).—

* * *

(B) TEMPORARY INVESTMENTS.—Under regulations prescribed by the Secretary—

* * *

(ii) ADDITIONAL PERIOD FOR CERTAIN BONDS.—

(I) IN GENERAL.—In the case of an issue described in subclause (II), clause (i) shall be applied by substituting "1 year" for "6 months" each place it appears with respect to the portion of the proceeds of the issue which are not expended in accordance with clause (i) if such portion does not exceed *5 percent of the proceeds of the issue.*

* * *

(C) EXCEPTION FROM REBATE FOR CERTAIN PROCEEDS TO BE USED TO FINANCE CONSTRUCTION EXPENDITURES.—

* * *

(xvii) TREATMENT OF BONA FIDE DEBT SERVICE FUNDS.—If the spending requirements of clause (ii) are met with respect to the available construction proceeds of a construction issue, then paragraph (2) shall not apply to earnings on a bona fide debt service fund for such issue.

(D) EXCEPTION FOR GOVERMENTAL UNITS ISSUING $5,000,000 OR LESS OF BONDS.—

* * *

(vii) INCREASE IN EXCEPTION FOR BONDS FINANCING PUBLIC SCHOOL CAPITAL EXPENDITURES.—Each of the $5,000,000 amounts in the preceding provisions of this subparagraph shall be increased by the lesser of $5,000,000 or so much of the aggregate face amount of the bonds as are attributable to financing the construction (within the meaning of subparagraph (C)(iv)) of public school facilities.

(E) *[Stricken.]*

* * *

[CCH Explanation at ¶ 355, 356, 357, 358 and 359. Committee Reports at ¶ 10,225, 12,915, 12,920, 12,925 and 12,930.]

Amendment Notes

Act Sec. 223(a) amended Code Sec. 148(f)(4)(D) by adding at the end a new clause (vii) to read as above.

The above amendment applies to bonds issued after December 31, 1997.

Act Sec. 1441 amended Code Sec. 148(f)(4)(B)(ii)(I) by striking "the lesser of 5 percent of the proceeds of the issue or $100,000" and inserting "5 percent of the proceeds of the issue".

Act Sec. 1442 amended Code Sec. 148(f)(4)(C) by adding at the end a new clause (xvii) to read as above.

Act Sec. 1444(b) amended Code Sec. 148(f)(4) by striking subparagraph (E). Prior to being stricken, Code Sec. 148(f)(4)(E) read as follows:

(E) EXCEPTION FOR CERTAIN QUALIFIED STUDENT LOAN BONDS.

(i) IN GENERAL.—In determining the aggregate amount earned on nonpurpose investments acquired with gross proceeds of an issue of bonds for a program described in section 144(b)(1)(A), the amount earned from investment of net proceeds of such issue during the initial temporary period under subsection (c) shall not be taken into account to the extent that the amount so earned is used to pay the reasonable—

(I) administrative costs of such program attributable to such issue and the costs of carrying such issue, and

(II) costs of issuing such issue,

but only to the extent such costs were financed with proceeds of such issue and for which the issuer was not reimbursed. Amounts designated as interest on student loans shall not be taken into account in determining whether the issuer is reimbursed for such costs. Except as otherwise hereafter provided in regulations prescribed by the Secretary, costs described in subclause (I) paid from amounts earned as described in the first sentence of this clause may also be taken into account in determining the yield on the student loans under a program described in section 144(b)(1)(A).

(ii) ONLY ARBITRAGE ON AMOUNTS LOANED DURING TEMPORARY PERIOD TAKEN INTO ACCOUNT FOR ADMINISTRATIVE COSTS, ETC.—The amount earned from investment of net proceeds of an issue during the initial temporary period under subsection (c) shall be taken into account under clause (i)(I) only to the extent attributable to proceeds which were used to make or finance (not later than the close of such period) student loans under a program described in section 144(b)(1)(A).

(iii) ELECTION.—This subparagraph shall not apply to any issue if the issuer elects not to have this subparagraph apply to such issue.

(iv) TERMINATION.—This subparagraph shall not apply to any bond issued after December 31, 1988.

The above amendments apply to bonds issued after the date of the enactment of this Act.

[¶ 5067] CODE SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) IN GENERAL.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

For purposes of the preceding sentence, the place of residence of a Member of Congress (including any Delegate and Resident Commissioner) within the State, congressional district, or possession which he represents in Congress shall be considered his home, but amounts expended by such Members within each taxable year for living expenses shall not be deductible for income tax purposes in excess of $3,000. For purposes of paragraph (2), the taxpayer shall not be treated as being temporarily away from home during any period of employment if such period exceeds 1 year. *The preceding sentence shall not apply to any Federal employee during any period for which such employee is certified by the Attorney General (or the designee thereof) as traveling on behalf of the United States in temporary duty status to investigate, or provide support services for the investigation of, a Federal crime.*

* * *

Amendment Notes

Act Sec. 1204(a) amended Code Sec. 162(a) by adding at the end a new sentence to read as above.

The above amendment applies to amounts paid or incurred with respect to tax years ending after the date of the enactment of this Act.

(l) SPECIAL RULES FOR HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.—

(1) ALLOWANCE OF DEDUCTION.—

* * *

(B) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A), the applicable percentage shall be determined under the following table:

For taxable years beginning in calendar year—	*The applicable percentage is—*
1997	*40*
1998 and 1999	*45*
2000 and 2001	*50*
2002	*60*
2003 through 2005	*80*
2006	*90*
2007 and thereafter	*100*

(2) LIMITATIONS.—

* * *

(B) OTHER COVERAGE.—Paragraph (1) shall not apply to any taxpayer for any calendar month for which the taxpayer is eligible to participate in any subsidized health plan maintained by any employer of the taxpayer or of the spouse of the taxpayer. *The preceding sentence shall be applied separately with respect to—*

(i) plans which include coverage for qualified long-term care services (as defined in section 7702B(c)) or are qualified long-term care insurance contracts (as defined in section 7702B(b)), and

(ii) plans which do not include such coverage and are not such contracts.

* * *

Amendment Notes

Act Sec. 934(a) amended Code Sec. 162(l)(1)(B) by amending the table to read as above. Prior to amendment, Code Sec. 162(l)(1)(B) read as follows:

(B) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A), the applicable percentage shall be determined under the following table:

For taxable years beginning in calendar year—	*The applicable percentage is—*
1997	40 percent
1998 through 2002	45 percent
2003	50 percent
2004	60 percent
2005	70 percent
2006 or thereafter	80 percent

The above amendment applies to tax years beginning after December 31, 1996.

Act Sec. 1602(c) amended Code Sec. 162(l)(2)(B) by adding at the end a new sentence to read as above.

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which such amendment relates.

(o) TREATMENT OF CERTAIN REIMBURSED EXPENSES OF RURAL MAIL CARRIERS.—

(1) GENERAL RULE.—In the case of any employee of the United States Postal Service who performs services involving the collection and delivery of mail on a rural route and who receives qualified reimbursements for the expenses incurred by such employee for the use of a vehicle in performing such services—

(A) the amount allowable as a deduction under this chapter for the use of a vehicle in performing such services shall be equal to the amount of such qualified reimbursements; and

(B) such qualified reimbursements shall be treated as paid under a reimbursement or other expense allowance arrangement for purposes of section 62(a)(2)(A) (and section 62(c) shall not apply to such qualified reimbursements).

(2) DEFINITION OF QUALIFIED REIMBURSEMENTS.—For purposes of this subsection, the term "qualified reimbursements" means the amounts paid by the United States Postal Service to employees as an equipment maintenance allowance under the 1991 collective bargaining agreement between the United States Postal Service and the National Rural Letter Carriers' Association. Amounts paid as an equipment maintenance allowance by such Postal Service under later collective bargaining agreements that supersede the 1991 agreement shall be considered qualified reimbursements if such amounts do not exceed the amounts that would have been paid under the 1991 agreement, adjusted for changes in the Consumer Price Index (as defined in section 1(f)(5)) since 1991.

Amendment Notes

Act Sec. 1203(a) amended Code Sec. 162 by redesignating subsection (o) as subsection (p) and by inserting after subsection (n) a new subsection (o) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

(p) CROSS REFERENCE.—

* * *

[CCH Explanation at ¶ 113, 115, 837 and 863. Committee Reports at ¶ 10,670, 12,130, 12,135 and 13,820.]

Amendment Notes

Act Sec. 1203(a) amended Code Sec. 162 by redesignating subsection (o) as subsection (p).

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5069] CODE SEC. 163. INTEREST.

* * *

(h) DISALLOWANCE OF DEDUCTION FOR PERSONAL INTEREST.—

* * *

(2) PERSONAL INTEREST.—For purposes of this subsection, the term "personal interest" means any interest allowable as a deduction under this chapter other than—

(A) interest paid or accrued on indebtedness properly allocable to a trade or business (other than the trade or business of performing services as an employee),

(B) any investment interest (within the meaning of subsection (d)),

(C) any interest which is taken into account under section 469 in computing income or loss from a passive activity of the taxpayer,

(D) any qualified residence interest (within the meaning of paragraph (3)), and

(E) any interest payable under section 6601 on any unpaid portion of the tax imposed by section 2001 for the period during which an extension of time for payment of such tax is in effect under section 6163.

* * *

(5) [(4)] OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) QUALIFIED RESIDENCE.—For purposes of this subsection—

(i) IN GENERAL.—The term "qualified residence" means—

(I) the principal residence (within the meaning of *section 121*) of the taxpayer, and

(II) 1 other residence of the taxpayer which is selected by the taxpayer for purposes of this subsection for the taxable year and which is used by the taxpayer as a residence (within the meaning of section 280A(d)(1)).

* * *

Amendment Notes

Act Sec. 312(d)(1) amended Code Sec. 163(h)(4)(A)(i)(I) by striking "section 1034" and inserting "section 121".

The above amendment applies to sales and exchanges after May 6, 1997.

Act Sec. 503(b)(2)(B) amended Code Sec. 163(h)(2)(E) by striking "or 6166" and all that follows and inserting a period. Prior to amendment, Code Sec. 163(h)(2)(E) read as follows:

(E) any interest payable under section 6601 on any unpaid portion of the tax imposed by section 2001 for the period during which an extension of time for payment of such tax is in effect under section 6163 or 6166 or under section 6166A (as in effect before its repeal by the Economic Recovery Tax Act of 1981).

The above amendment generally applies to estates of decedents dying after December 31, 1997. For a special rule, see Act Sec. 503(d)(2), below.

Act Sec. 503(d)(2) provides:

(2) ELECTION.—In the case of the estate of any decedent dying before January 1, 1998, with respect to which there is an election under section 6166 of the Internal Revenue Code of 1986, the executor of the estate may elect to have the amendments made by this section apply with respect to installments due after the effective date of the election; except that the 2-percent portion of such installments shall be equal to the amount which would be the 4-percent portion of such installments without regard to such election. Such an election shall be made before January 1, 1999 in the manner prescribed by the Secretary of the Treasury and, once made, is irrevocable.

(j) LIMITATION ON DEDUCTION FOR INTEREST ON CERTAIN INDEBTEDNESS.—

* * *

(2) CORPORATIONS TO WHICH SUBSECTION APPLIES.—

* * *

(B) EXCESS INTEREST EXPENSE.—

* * *

(iii) EXCESS LIMITATION.—For purposes of *clause (ii)*, the term "excess limitation" means the excess (if any) of—

(I) 50 percent of the adjusted taxable income of the corporation, over

(II) the corporation's net interest expense.

* * *

Amendment Notes

Act Sec. 1604(g)(1) amended Code Sec. 163(j)(2)(B)(iii) by striking "clause (i)" and inserting "clause (ii)".

The above amendment is effective on the date of the enactment of this Act.

(k) SECTION 6166 INTEREST.—No deduction shall be allowed under this section for any interest payable under section 6601 on any unpaid portion of the tax imposed by section 2001 for the period during which an extension of time for payment of such tax is in effect under section 6166.

Amendment Notes

Act Sec. 503(b)(2)(A) amended Code Sec. 163 by redesignating subsection (k) as subsection (l) and by inserting after subsection (j) a new subsection (k) to read as above.

The above amendment generally applies to estates of decedents dying after December 31, 1997. For a special rule, see Act Sec. 503(d)(2) in the amendment notes following Code Sec. 163(h), above.

(l) DISALLOWANCE OF DEDUCTION ON CERTAIN DEBT INSTRUMENTS OF CORPORATIONS.—

(1) IN GENERAL.—No deduction shall be allowed under this chapter for any interest paid or accrued on a disqualified debt instrument.

(2) DISQUALIFIED DEBT INSTRUMENT.—For purposes of this subsection, the term "disqualified debt instrument" means any indebtedness of a corporation which is payable in equity of the issuer or a related party.

(3) SPECIAL RULES FOR AMOUNTS PAYABLE IN EQUITY.—For purposes of paragraph (2), indebtedness shall be treated as payable in equity of the issuer or a related party only if—

(A) a substantial amount of the principal or interest is required to be paid or converted, or at the option of the issuer or a related party is payable in, or convertible into, such equity,

(B) a substantial amount of the principal or interest is required to be determined, or at the option of the issuer or a related party is determined, by reference to the value of such equity, or

(C) the indebtedness is part of an arrangement which is reasonably expected to result in a transaction described in subparagraph (A) or (B).

For purposes of this paragraph, principal or interest shall be treated as required to be so paid, converted, or determined if it may be required at the option of the holder or a related party and there is a substantial certainty the option will be exercised.

(4) RELATED PARTY.—For purposes of this subsection, a person is a related party with respect to another person if such person bears a relationship to such other person described in section 267(b) or 707(b).

(5) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, including regulations preventing avoidance of this subsection through the use of an issuer other than a corporation.

Amendment Notes

Act Sec. 1005(a) amended Code Sec. 163, as amended by title V, by redesignating subsection (l) as subsection (m) and by inserting after subsection (k) a new subsection (l) to read as above.

The above amendment generally applies to disqualified debt instruments issued after June 8, 1997. For a transitional rule, see Act Sec. 1005(b)(2)(A)-(C), below.

Act Sec. 1005(b)(2)(A)-(C) provides:

(2) TRANSITION RULE.—The amendment made by this section shall not apply to any instrument issued after June 8, 1997, if such instrument is—

(A) issued pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the issuance.

(m) CROSS REFERENCES.—

* * *

[CCH Explanation at ¶ 129, 227 and 513. Committee Reports at ¶ 10,315, 10,380 and 11,140.]

Amendment Notes

Act Sec. 503(b)(2)(A) amended Code Sec. 163 by redesignating subsection (k) as subsection (l).

The above amendment generally applies to estates of decedents dying after December 31, 1997. For a special rule, see Act Sec. 503(d)(2) in the amendment notes following Code Sec. 163(h), above.

Act Sec. 1005(a) amended Code Sec. 163, as amended by title V, by redesignating subsection (l) as subsection (m).

The above amendment generally applies to disqualified debt instruments issued after June 8, 1997. For a transitional rule, see Act Sec. 1005(b)(2)(A)-(C) in the amendment notes following Code Sec. 163(l), above.

[¶ 5071] CODE SEC. 165. LOSSES.

* * *

(i) DISASTER LOSSES.—

* * *

(4) USE OF DISASTER LOAN APPRAISALS TO ESTABLISH AMOUNT OF LOSS.—Nothing in this title shall be construed to prohibit the Secretary from prescribing regulations or other guidance under which an appraisal for the purpose of obtaining a loan of Federal funds or a loan guarantee from the Federal Government as a result of a Presidentially declared disaster (as defined by section 1033(h)(3)) may be used to establish the amount of any loss described in paragraph (1) or (2).

* * *

[CCH Explanation at ¶ 103. Committee Reports at ¶ 10,590.]

Amendment Notes

Act Sec. 912(a) amended Code Sec. 165(i) by adding at the end a new paragraph (4) to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5073] CODE SEC. 167. DEPRECIATION.

* * *

(g) DEPRECIATION UNDER INCOME FORECAST METHOD.—

* * *

(6) LIMITATION ON PROPERTY FOR WHICH INCOME FORECAST METHOD MAY BE USED.—The depreciation deduction allowable under this section may be determined under the income forecast method or any similar method only with respect to—

(A) property described in paragraph (3) or (4) of section 168(f),

(B) copyrights,

(C) books,

(D) patents, and

(E) other property specified in regulations.

Such methods may not be used with respect to any amortizable section 197 intangible (as defined in section 197(c)).

* * *

[CCH Explanation at ¶ 325. Committee Reports at ¶ 11,540.]

Amendment Notes

Act Sec. 1086(a) amended Code Sec. 167(g) by adding at the end a new paragraph (6) to read as above.

The above amendment applies to property placed in service after the date of the enactment of this Act.

[¶ 5075] CODE SEC. 168. ACCELERATED COST RECOVERY SYSTEM.

* * *

(e) CLASSIFICATION OF PROPERTY.—For purposes of this section—

* * *

(3) CLASSIFICATION OF CERTAIN PROPERTY.—

(A) 3-YEAR PROPERTY.—The term "3-year property" includes—

(i) any race horse which is more than 2 years old at the time it is placed in service,

(ii) any horse other than a race horse which is more than 12 years old at the time it is placed in service, *and*

(iii) any qualified rent-to-own property.

* * *

Amendment Notes

Act Sec. 1086(b)(1) amended Code Sec. 168(e)(3)(A) by striking "and" at the end of clause (i), by striking the period at the end of clause (ii) and inserting ", and", and by adding at the end a new clause (iii) to read as above.

The above amendment applies to property placed in service after the date of the enactment of this Act.

(g) ALTERNATIVE DEPRECIATION SYSTEM FOR CERTAIN PROPERTY.—

* * *

(3) SPECIAL RULES FOR DETERMINING CLASS LIFE.—

* * *

(B) SPECIAL RULE FOR CERTAIN PROPERTY ASSIGNED TO CLASSES.—For purposes of paragraph (2), in the case of property described in any of the following subparagraphs of subsection (e)(3), the class life shall be determined as follows:

If property is described in subparagraph:	*The class life is:*
(A)(iii)	*4*
(B)(ii)	5
(B)(iii)	9.5
(C)(i)	10
(D)(i)	15
(D)(ii)	20
(E)(i)	24
(E)(ii)	24
(E)(iii)	20

* * *

Amendment Notes

Act Sec. 1086(b)(2) amended the table contained in Code Sec. 168(g)(3)(B) by inserting before the first item a new item to read as above.

The above amendment applies to property placed in service after the date of the enactment of this Act.

(i) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

* * *

(8) TREATMENT OF LEASEHOLD IMPROVEMENTS.—

* * *

(C) CROSS REFERENCE.—

For treatment of qualified long-term real property constructed or improved in connection with cash or rent reduction from lessor to lessee, see section 110(b).

* * *

(14) QUALIFIED RENT-TO-OWN PROPERTY.—

(A) IN GENERAL.—The term "qualified rent-to-own property" means property held by a rent-to-own dealer for purposes of being subject to a rent-to-own contract.

(B) RENT-TO-OWN DEALER.—The term "rent-to-own dealer" means a person that, in the ordinary course of business, regularly enters into rent-to-own contracts with customers for the use of consumer property, if a substantial portion of those contracts terminate and the property is returned to such person before the receipt of all payments required to transfer ownership of the property from such person to the customer.

(C) CONSUMER PROPERTY.—The term "consumer property" means tangible personal property of a type generally used within the home for personal use.

(D) RENT-TO-OWN CONTRACT.—The term "rent-to-own contract" means any lease for the use of consumer property between a rent-to-own dealer and a customer who is an individual which—

(i) is titled "Rent-to-Own Agreement" or "Lease Agreement with Ownership Option," or uses other similar language,

(ii) provides for level (or decreasing where no payment is less than 40 percent of the largest payment), regular periodic payments (for a payment period which is a week or month),

(iii) provides that legal title to such property remains with the rent-to-own dealer until the customer makes all the payments described in clause (ii) or early purchase payments required under the contract to acquire legal title to the item of property,

(iv) provides a beginning date and a maximum period of time for which the contract may be in effect that does not exceed 156 weeks or 36 months from such beginning date (including renewals or options to extend),

(v) provides for payments within the 156-week or 36-month period that, in the aggregate, generally exceed the normal retail price of the consumer property plus interest,

(vi) provides for payments under the contract that, in the aggregate, do not exceed $10,000 per item of consumer property,

(vii) provides that the customer does not have any legal obligation to make all the payments referred to in clause (ii) set forth under the contract, and that at the end of each payment period the customer may either continue to use the consumer property by making the payment for the next payment period or return such property to the rent-to-own dealer in good working order, in which case the customer does not incur any further obligations

under the contract and is not entitled to a return of any payments previously made under the contract, and

(viii) provides that the customer has no right to sell, sublease, mortgage, pawn, pledge, encumber, or otherwise dispose of the consumer property until all the payments stated in the contract have been made.

Amendment Notes

Act Sec. 1086(b)(3) amended Code Sec. 168(i) by adding at the end a new paragraph (14) to read as above.

The above amendment applies to property placed in service after the date of the enactment of this Act.

Act Sec. 1213(c) amended Code Sec. 168(i)(8) by adding at the end a new subparagraph (C) to read as above.

The above amendment applies to leases entered into after the date of the enactment of this Act.

(j) PROPERTY ON INDIAN RESERVATIONS.—

* * *

(6) INDIAN RESERVATION DEFINED.—For purposes of this subsection, the term "Indian reservation" means a reservation, as defined in—

(A) section 3(d) of the Indian Financing Act of 1974 (25 U.S.C. 1452(d)), or

(B) section 4(10) of the Indian Child Welfare Act of 1978 (25 U.S.C. 1903(10)).

For purposes of the preceding sentence, such section 3(d) shall be applied by treating the term "former Indian reservations in Oklahoma" as including only lands which are within the jurisdictional area of an Oklahoma Indian tribe (as determined by the Secretary of the Interior) and are recognized by such Secretary as eligible for trust land status under 25 CFR Part 151 (as in effect on the date of the enactment of this sentence).

* * *

[CCH Explanation at ¶ 322, 325 and 328. Committee Reports at ¶ 11,540, 12,175 and 13,940.]

Amendment Notes

Act Sec. 1604(c)(1) amended Code Sec. 168(j)(6) by adding at the end a new flush sentence to read as above.

For the effective date of the above amendment, see Act Sec. 1604(c)(2)(A)-(B), below.

Act Sec. 1604(c)(2)(A)-(B) provides:

(2) The amendment made by paragraph (1) shall apply as if included in the amendments made by section 13321 of the Omnibus Budget Reconciliation Act of 1993, except that such amendment shall not apply—

(A) with respect to property (with an applicable recovery period under section 168(j) of the Internal Revenue Code of 1986 of 6 years or less) held by the taxpayer if the taxpayer claimed the benefits of section 168(j) of such Code with respect to such property on a return filed before March 18, 1997, but only if such return is the first return of tax filed for the taxable year in which such property was placed in service, or

(B) with respect to wages for which the taxpayer claimed the benefits of section 45A of such Code for a taxable year on a return filed before March 18, 1997, but only if such return was the first return of tax filed for such taxable year.

[¶ 5077] CODE SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

* * *

(e) CERTAIN CONTRIBUTIONS OF ORDINARY INCOME AND CAPITAL GAIN PROPERTY.—

* * *

(5) SPECIAL RULE FOR CONTRIBUTIONS OF STOCK FOR WHICH MARKET QUOTATIONS ARE READILY AVAILABLE.—

* * *

(D) TERMINATION.—This paragraph shall not apply to contributions made—

(i) after December 31, 1994, and before July 1, 1996, or

(ii) after *June 30, 1998.*

(6) SPECIAL RULE FOR CONTRIBUTIONS OF COMPUTER TECHNOLOGY AND EQUIPMENT FOR ELEMENTARY OR SECONDARY SCHOOL PURPOSES.—

(A) LIMIT ON REDUCTION.—In the case of a qualified elementary or secondary educational contribution, the reduction under paragraph (1)(A) shall be no greater than the amount determined under paragraph (3)(B).

(B) QUALIFIED ELEMENTARY OR SECONDARY EDUCATIONAL CONTRIBUTION.—For purposes of this paragraph, the term "qualified elementary or secondary educational contribution" means a charitable contribution by a corporation of any computer technology or equipment, but only if—

(i) the contribution is to—

(I) an educational organization described in subsection (b)(1)(A)(ii), or

(II) an entity described in section 501(c)(3) and exempt from tax under section 501(a) (other than an entity described in subclause (I)) that is organized primarily for purposes of supporting elementary and secondary education,

(ii) the contribution is made not later than 2 years after the date the taxpayer acquired the property (or in the case of property constructed by the taxpayer, the date the construction of the property is substantially completed),

(iii) the original use of the property is by the donor or the donee,

(iv) substantially all of the use of the property by the donee is for use within the United States for educational purposes in any of the grades K0912 that are related to the purpose or function of the organization or entity,

(v) the property is not transferred by the donee in exchange for money, other property, or services, except for shipping, installation and transfer costs,

(vi) the property will fit productively into the entity's education plan, and

(vii) the entity's use and disposition of the property will be in accordance with the provisions of clauses (iv) and (v).

(C) CONTRIBUTION TO PRIVATE FOUNDATION.—A contribution by a corporation of any computer technology or equipment to a private foundation (as defined in section 509) shall be treated as a qualified elementary or secondary educational contribution for purposes of this paragraph if—

(i) the contribution to the private foundation satisfies the requirements of clauses (ii) and (v) of subparagraph (B), and

(ii) within 30 days after such contribution, the private foundation—

(I) contributes the property to an entity described in clause (i) of subparagraph (B) that satisfies the requirements of clauses (iv) through (vii) of subparagraph (B), and

(II) notifies the donor of such contribution.

(D) SPECIAL RULE RELATING TO CONSTRUCTION OF PROPERTY.—For the purposes of this paragraph, the rules of paragraph (4)(C) shall apply.

(E) DEFINITIONS.—For the purposes of this paragraph—

(i) COMPUTER TECHNOLOGY OR EQUIPMENT.—The term "computer technology or equipment" means computer software (as defined by section 197(e)(3)(B)), computer or peripheral equipment (as defined by section 168(i)(2)(B)), and fiber optic cable related to computer use.

(ii) CORPORATION.—The term "corporation" has the meaning given to such term by paragraph (4)(D).

(F) TERMINATION.—This paragraph shall not apply to any contribution made during any taxable year beginning after December 31, 1999.

* * *

Amendment Notes

Act Sec. 224(a) amended Code Sec. 170(e) by adding a new paragraph (6) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

Act Sec. 602(a) amended Code Sec. 170(e)(5)(D)(ii) by striking "May 31, 1997" and inserting "June 30, 1998".

The above amendment applies to contributions made after May 31, 1997.

(h) QUALIFIED CONSERVATION CONTRIBUTION.—

* * *

(5) EXCLUSIVELY FOR CONSERVATION PURPOSES.—For purposes of this subsection—

* * *

(B) NO SURFACE MINING PERMITTED.—

* * *

(ii) SPECIAL RULE.—With respect to any contribution of property in which the ownership of the surface estate and mineral interests has been and remains separated, subparagraph (A) shall be treated as met if the probability of surface mining occurring on such property is so remote as to be negligible.

* * *

Amendment Notes

Act Sec. 508(d) amended Code Sec. 170(h)(5)(B)(ii) to read as above. Prior to amendment, Code Sec. 170(h)(5)(B)(ii) read as follows:

(ii) SPECIAL RULE.—With respect to any contribution of property in which the ownership of the surface estate and mineral interests were separated before June 13, 1976, and remain so separated, subparagraph (A) shall be treated as met if the probability of surface mining occurring on such property is so remote as to be negligible.

The above amendment applies to easements granted after December 31, 1997.

(i) STANDARD MILEAGE RATE FOR USE OF PASSENGER AUTOMOBILE.—For purposes of computing the deduction under this section for use of a passenger automobile, the standard mileage rate shall be 14 cents per mile.

* * *

[CCH Explanation at ¶ 105, 107, 214 and 519. Committee Reports at ¶ 10,230, 10,420, 10,440 and 10,895.]

Amendment Notes

Act Sec. 973(a) amended Code Sec. 170(i) to read as above. Prior to amendment, Code Sec. 170(i) read as follows:

(i) STANDARD MILEAGE RATE FOR USE OF PASSENGER AUTOMOBILE.—For purposes of computing the deduction under this section for use of a passenger automobile the standard mileage rate shall be 12 cents per mile.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5079] CODE SEC. 172. NET OPERATING LOSS DEDUCTION.

* * *

(b) NET OPERATING LOSS CARRYBACKS AND CARRYOVERS.—

(1) YEARS TO WHICH LOSS MAY BE CARRIED.—

(A) GENERAL RULE.—Except as otherwise provided in this paragraph, a net operating loss for any taxable year—

(i) shall be a net operating loss carryback to each of the *2* taxable years preceding the taxable year of such loss, and

(ii) shall be a net operating loss carryover to each of the *20* taxable years following the taxable year of the loss.

* * *

(F) RETENTION OF 3-YEAR CARRYBACK IN CERTAIN CASES.—

(i) IN GENERAL.—Subparagraph (A)(i) shall be applied by substituting "3 years" for "2 years" with respect to the portion of the net operating loss for the taxable year which is an eligible loss with respect to the taxpayer.

(ii) ELIGIBLE LOSS.—For purposes of clause (i), the term "eligible loss" means—

(I) in the case of an individual, losses of property arising from fire, storm, shipwreck, or other casualty, or from theft,

(II) in the case of a taxpayer which is a small business, net operating losses attributable to Presidentially declared disasters (as defined in section 1033(h)(3)), and

(III) in the case of a taxpayer engaged in the trade or business of farming (as defined in section 263A(e)(4)), net operating losses attributable to such Presidentially declared disasters.

(iii) SMALL BUSINESS.—For purposes of this subparagraph, the term "small business" means a corporation or partnership which meets the gross receipts test of section 448(c) for the taxable year in which the loss arose (or, in the case of a sole proprietorship, which would meet such test if such proprietorship were a corporation).

* * *

[CCH Explanation at ¶ 315. Committee Reports at ¶ 11,520.]

Amendment Notes

Act Sec. 1082(a)(1)-(2) amended Code Sec. 172(b)(1)(A) by striking "3" in clause (i) and inserting "2", and by striking "15" in clause (ii) and inserting "20".

Act Sec. 1082(b) amended Code Sec. 172(b)(1) by adding at the end a new subparagraph (F) to read as above.

The above amendments apply to net operating losses for tax years beginning after the date of the enactment of this Act.

[¶ 5081] *CODE SEC. 198. EXPENSING OF ENVIRONMENTAL REMEDIATION COSTS.*

(a) IN GENERAL.—A taxpayer may elect to treat any qualified environmental remediation expenditure which is paid or incurred by the taxpayer as an expense which is not chargeable to capital account. Any

expenditure which is so treated shall be allowed as a deduction for the taxable year in which it is paid or incurred.

(b) Qualified Environmental Remediation Expenditure.—For purposes of this section—

(1) In general.—The term "qualified environmental remediation expenditure" means any expenditure—

(A) which is otherwise chargeable to capital account, and

(B) which is paid or incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site.

(2) Special rule for expenditures for depreciable property.—Such term shall not include any expenditure for the acquisition of property of a character subject to the allowance for depreciation which is used in connection with the abatement or control of hazardous substances at a qualified contaminated site; except that the portion of the allowance under section 167 for such property which is otherwise allocated to such site shall be treated as a qualified environmental remediation expenditure.

(c) Qualified Contaminated Site.—For purposes of this section—

(1) Qualified contaminated site.—

(A) In general.—The term "qualified contaminated site" means any area—

(i) which is held by the taxpayer for use in a trade or business or for the production of income, or which is property described in section 1221(1) in the hands of the taxpayer,

(ii) which is within a targeted area, and

(iii) at or on which there has been a release (or threat of release) or disposal of any hazardous substance.

(B) Taxpayer must receive statement from State environmental agency.—An area shall be treated as a qualified contaminated site with respect to expenditures paid or incurred during any taxable year only if the taxpayer receives a statement from the appropriate agency of the State in which such area is located that such area meets the requirements of clauses (ii) and (iii) of subparagraph (A).

(C) Appropriate State agency.—For purposes of subparagraph (B), the chief executive officer of each State may, in consultation with the Administrator of the Environmental Protection Agency, designate the appropriate State environmental agency within 60 days of the date of the enactment of this section. If the chief executive officer of a State has not designated an appropriate State environmental agency within such 60-day period, the appropriate environmental agency for such State shall be designated by the Administrator of the Environmental Protection Agency.

(2) Targeted area.—

(A) In general.—The term "targeted area" means—

(i) any population census tract with a poverty rate of not less than 20 percent,

(ii) a population census tract with a population of less than 2,000 if—

(I) more than 75 percent of such tract is zoned for commercial or industrial use, and

(II) such tract is contiguous to 1 or more other population census tracts which meet the requirement of clause (i) without regard to this clause,

(iii) any empowerment zone or enterprise community (and any supplemental zone designated on December 21, 1994), and

(iv) any site announced before February 1, 1997, as being included as a brownfields pilot project of the Environmental Protection Agency.

(B) National priorities listed sites not included.—Such term shall not include any site which is on, or proposed for, the national priorities list under section 105(a)(8)(B) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (as in effect on the date of the enactment of this section).

(C) Certain rules to apply.—For purposes of this paragraph the rules of sections 1392(b)(4) and 1393(a)(9) shall apply.

(d) Hazardous Substance.—For purposes of this section—

(1) In general.—The term "hazardous substance" means—

(A) any substance which is a hazardous substance as defined in section 101(14) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, and

(B) any substance which is designated as a hazardous substance under section 102 of such Act.

(2) Exception.—Such term shall not include any substance with respect to which a removal or remedial action is not permitted under section 104 of such Act by reason of subsection (a)(3) thereof.

(e) Deduction Recaptured as Ordinary Income on Sale, Etc.—Solely for purposes of section 1245, in the case of property to which a qualified environmental remediation expenditure would have been capitalized but for this section—

(1) the deduction allowed by this section for such expenditure shall be treated as a deduction for depreciation, and

(2) such property (if not otherwise section 1245 property) shall be treated as section 1245 property solely for purposes of applying section 1245 to such deduction.

(f) Coordination With Other Provisions.—Sections 280B and 468 shall not apply to amounts which are treated as expenses under this section.

(g) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

(h) Termination.—This section shall not apply to expenditures paid or incurred after December 31, 2000.

* * *

[CCH Explanation at ¶ 330. Committee Reports at ¶ 10,715.]

Amendment Notes

Act Sec. 941(a) amended part VI of subchapter B of chapter 1 by adding at the end a new Code Sec. 198 to read as above.

The above amendment applies to expenditures paid or incurred after the date of the enactment of this Act, in tax years ending after such date.

[¶ 5083] CODE SEC. 216. DEDUCTION OF TAXES, INTEREST, AND BUSINESS DEPRECIATION BY COOPERATIVE HOUSING CORPORATION TENANT-STOCKHOLDER.

* * *

(e) Distributions by Cooperative Housing Corporations.—Except as provided in regulations, no gain or loss shall be recognized on the distribution by a cooperative housing corporation of a dwelling unit to a stockholder in such cooperation if such distribution is in exchange for the stockholder's stock in such corporation and *such dwelling unit is used as his principal residence (within the meaning of section 121).*

* * *

[CCH Explanation at ¶ 129. Committee Reports at ¶ 10,315.]

Amendment Notes

Act Sec. 312(d)(4) amended Code Sec. 216(e) by striking "such exchange qualifies for nonrecognition of gain under section 1034(f)" and inserting "such dwelling unit is used as his principal residence (within the meaning of section 121)".

The above amendment applies to sales and exchanges after May 6, 1997.

[¶ 5085] CODE SEC. 219. RETIREMENT SAVINGS.

* * *

(c) Special Rules for Certain Married Individuals.—

(1) In general.—In the case of an individual to whom this paragraph applies for the taxable year, the limitation of paragraph (1) of subsection (b) shall be equal to the lesser of—

(A) the dollar amount in effect under subsection (b)(1)(A) for the taxable year, or

(B) the sum of—

(i) the compensation includible in such individual's gross income for the taxable year, plus

(ii) the compensation includible in the gross income of such individual's spouse for the taxable year reduced by—

(I) the amount allowed as a deduction under subsection (a) to such spouse for such taxable year, and

(II) the amount of any contribution on behalf of such spouse to a Roth IRA under section 408A for such taxable year.

* * *

Amendment Notes

Act Sec. 302(c) amended Code Sec. 219(c)(1)(B)(ii) to read as above. Prior to amendment, Code Sec. 219(c)(1)(B)(ii) read as follows:

(ii) the compensation includible in the gross income of such individual's spouse for the taxable year reduced by the amount allowed as a deduction under subsection (a) to such spouse for such taxable year.

The above amendment applies to tax years beginning after December 31, 1997.

(g) LIMITATION ON DEDUCTION FOR ACTIVE PARTICIPANTS IN CERTAIN PENSION PLANS.—

(1) IN GENERAL.—If (for any part of any plan year ending with or within a taxable year) an individual is an active participant, each of the dollar limitations contained in subsections (b)(1)(A) and (c)(1)(A) for such taxable year shall be reduced (but not below zero) by the amount determined under paragraph (2).

(2) AMOUNT OF REDUCTION.—

(A) IN GENERAL.—The amount determined under this paragraph with respect to any dollar limitation shall be the amount which bears the same ratio to such limitation as—

(i) the excess of—

(I) the taxpayer's adjusted gross income for such taxable year, over

(II) the applicable dollar amount, bears to

(ii) $10,000 *($20,000 in the case of a joint return for a taxable year beginning after December 31, 2006).*

* * *

(3) ADJUSTED GROSS INCOME; APPLICABLE DOLLAR AMOUNT.—For purposes of this subsection—

* * *

(B) APPLICABLE DOLLAR AMOUNT.—The term "applicable dollar amount" means the following:

(i) In the case of a taxpayer filing a joint return:

For taxable years beginning in:	*The applicable dollar amount is:*
1998	*$50,000*
1999	*$51,000*
2000	*$52,000*
2001	*$53,000*
2002	*$54,000*
2003	*$60,000*
2004	*$65,000*
2005	*$70,000*
2006	*$75,000*
2007 and thereafter	*$80,000*

(ii) In the case of any other taxpayer (other than a married individual filing a separate return):

For taxable years beginning in:	*The applicable dollar amount is:*
1998	*$30,000*
1999	*$31,000*
2000	*$32,000*
2001	*$33,000*
2002	*$34,000*
2003	*$40,000*
2004	*$45,000*
2005 and thereafter	*$50,000*

(iii) In the case of a married individual filing a separate return, zero.

* * *

(7) SPECIAL RULE FOR CERTAIN SPOUSES.—In the case of an individual who is an active participant at no time during any plan year ending with or within the taxable year but whose spouse is an active participant for any part of any such plan year—

(A) the applicable dollar amount under paragraph (3)(B)(i) with respect to the taxpayer shall be $150,000, and

(B) the amount applicable under paragraph (2)(A)(ii) shall be $10,000.

* * *

[CCH Explanation at ¶ 166, 172 and 173. Committee Reports at ¶ 10,255 and 10,260.]

Amendment Notes

Act Sec. 301(a)(1) amended Code Sec. 219(g)(3)(B) to read as above. Prior to amendment, Code Sec. 219(g)(3)(B) read as follows:

(B) APPLICABLE DOLLAR AMOUNT.—The term "applicable dollar amount" means—

(i) in the case of a taxpayer filing a joint return, $40,000,

(ii) in the case of any other taxpayer (other than a married individual filing a separate return), $25,000, and

(iii) in the case of a married individual filing a separate return, zero.

Act Sec. 301(a)(2) amended Code Sec. 219(g)(2)(A)(ii) by inserting "($20,000 in the case of a joint return for a taxable year beginning after December 31, 2006)".

Act Sec. 301(b)(1)-(2) amended Code Sec. 219(g) by striking "or the individual's spouse" after "an individual" in paragraph (1), and by adding at the end a new paragraph (7) to read as above.

The above amendments apply to tax years beginning after December 31, 1997.

[¶ 5087] CODE SEC. 220. MEDICAL SAVINGS ACCOUNTS.

* * *

(b) LIMITATIONS.—

* * *

[Caution: Code Sec. 220(b)(7), as amended by Act Sec. 4006(b)(2) of the Balanced Budget Act of 1997, applies to tax years beginning after December 31, 1998.—CCH.]

(7) MEDICARE ELIGIBLE INDIVIDUALS.—The limitation under this subsection for any month with respect to an individual shall be zero for the first month such individual is entitled to benefits under title XVIII of the Social Security Act and for each month thereafter.

Balanced Budget Act

Act Sec. 4006(b)(2) amended Code Sec. 220(b) by adding at the end a new paragraph (7) to read as above.

The above amendment applies to tax years beginning after December 31, 1998.

(c) DEFINITIONS.—For purposes of this section—

* * *

(3) PERMITTED INSURANCE.—The term "permitted insurance" means—

(A) insurance if substantially all of the coverage provided under such insurance relates to—

(i) liabilities incurred under workers' compensation laws,

(ii) tort liabilities,

(iii) liabilities relating to ownership or use of property, or

(iv) such other similar liabilities as the Secretary may specify by regulations,

(B) insurance for a specified disease or illness, and

(C) insurance paying a fixed amount per day (or other period) of hospitalization.

* * *

Amendment Notes

Act Sec. 1602(a)(2) amended Code Sec. 220(c)(3) by striking subparagraph (A) and redesignating subparagraphs (B) through (D) as subparagraphs (A) through (C), respectively. Prior to being stricken, Code Sec. 220(c)(3)(A) read as follows:

(A) Medicare supplemental insurance,

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

(d) MEDICAL SAVINGS ACCOUNT.—For purposes of this section—

* * *

(2) QUALIFIED MEDICAL EXPENSES.—

* * *

(C) MEDICAL EXPENSES OF INDIVIDUALS WHO ARE NOT ELIGIBLE INDIVIDUALS.—Subparagraph (A) shall apply to an amount paid by an account holder for medical care of an individual who is

not *described in clauses (i) and (ii) of subsection (c)(1)(A)* for the month in which the expense for such care is incurred only if no amount is contributed (other than a rollover contribution) to any medical savings account of such account holder for the taxable year which includes such month. This subparagraph shall not apply to any expense for coverage described in subclause (I) or (III) of subparagraph (B)(ii).

* * *

[CCH Explanation at ¶ 804 and 807. Committee Reports at ¶ 13,760 and 13,765.]

Amendment Notes

Act Sec. 1602(a)(3) amended Code Sec. 220(d)(2)(C) by striking "an eligible individual" and inserting "described in clauses (i) and (ii) of subsection (c)(1)(A)".

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

[¶ 5089] ***CODE SEC. 221. INTEREST ON EDUCATION LOANS.***

(a) ALLOWANCE OF DEDUCTION.—In the case of an individual, there shall be allowed as a deduction for the taxable year an amount equal to the interest paid by the taxpayer during the taxable year on any qualified education loan.

(b) MAXIMUM DEDUCTION.—

(1) IN GENERAL.—Except as provided in paragraph (2), the deduction allowed by subsection (a) for the taxable year shall not exceed the amount determined in accordance with the following table:

In the case of taxable years beginning in:	*The dollar amount is:*
1998	*$1,000*
1999	*$1,500*
2000	*$2,000*
2001 or thereafter	*$2,500*

(2) LIMITATION BASED ON MODIFIED ADJUSTED GROSS INCOME.—

(A) IN GENERAL.—The amount which would (but for this paragraph) be allowable as a deduction under this section shall be reduced (but not below zero) by the amount determined under subparagraph (B).

(B) AMOUNT OF REDUCTION.—The amount determined under this subparagraph is the amount which bears the same ratio to the amount which would be so taken into account as—

(i) the excess of—

(I) the taxpayer's modified adjusted gross income for such taxable year, over

(II) $40,000 ($60,000 in the case of a joint return), bears to

(ii) $15,000.

(C) MODIFIED ADJUSTED GROSS INCOME.—The term "modified adjusted gross income" means adjusted gross income determined—

(i) without regard to this section and sections 135, 137, 911, 931, and 933, and

(ii) after application of sections 86, 219, and 469.

For purposes of sections 86, 135, 137, 219, and 469, adjusted gross income shall be determined without regard to the deduction allowed under this section.

(c) DEPENDENTS NOT ELIGIBLE FOR DEDUCTION.—No deduction shall be allowed by this section to an individual for the taxable year if a deduction under section 151 with respect to such individual is allowed to another taxpayer for the taxable year beginning in the calendar year in which such individual's taxable year begins.

(d) LIMIT ON PERIOD DEDUCTION ALLOWED.—A deduction shall be allowed under this section only with respect to interest paid on any qualified education loan during the first 60 months (whether or not consecutive) in which interest payments are required. For purposes of this paragraph, any loan and all refinancings of such loan shall be treated as 1 loan.

(e) DEFINITIONS.—For purposes of this section—

(1) QUALIFIED EDUCATION LOAN.—The term "qualified education loan" means any indebtedness incurred to pay qualified higher education expenses—

(A) which are incurred on behalf of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred,

(B) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred, and

(C) which are attributable to education furnished during a period during which the recipient was an eligible student.

Such term includes indebtedness used to refinance indebtedness which qualifies as a qualified education loan. The term "qualified education loan" shall not include any indebtedness owed to a person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer.

(2) QUALIFIED HIGHER EDUCATION EXPENSES.—The term "qualified higher education expenses" means the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll, as in effect on the day before the date of the enactment of this Act) at an eligible educational institution, reduced by the sum of—

(A) the amount excluded from gross income under section 127, 135, or 530 by reason of such expenses, and

(B) the amount of any scholarship, allowance, or payment described in section 25A(g)(2).

For purposes of the preceding sentence, the term "eligible educational institution" has the same meaning given such term by section 25A(f)(2), except that such term shall also include an institution conducting an internship or residency program leading to a degree or certificate awarded by an institution of higher education, a hospital, or a health care facility which offers postgraduate training.

(3) ELIGIBLE STUDENT.—The term "eligible student" has the meaning given such term by section 25A(b)(3).

(4) DEPENDENT.—The term "dependent" has the meaning given such term by section 152.

(f) SPECIAL RULES.—

(1) DENIAL OF DOUBLE BENEFIT.—No deduction shall be allowed under this section for any amount for which a deduction is allowable under any other provision of this chapter.

(2) MARRIED COUPLES MUST FILE JOINT RETURN.—If the taxpayer is married at the close of the taxable year, the deduction shall be allowed under subsection (a) only if the taxpayer and the taxpayer's spouse file a joint return for the taxable year.

(3) MARITAL STATUS.—Marital status shall be determined in accordance with section 7703.

(g) INFLATION ADJUSTMENTS.—

(1) IN GENERAL.—In the case of a taxable year beginning after 2002, the $40,000 and $60,000 amounts in subsection (b)(2) shall each be increased by an amount equal to—

(A) such dollar amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "calendar year 2001" for "calendar year 1992" in subparagraph (B) thereof.

(2) ROUNDING.—If any amount as adjusted under paragraph (1) is not a multiple of $5,000, such amount shall be rounded to the next lowest multiple of $5,000.

[CCH Explanation at ¶ 157. Committee Reports at ¶ 10,145.]

Amendment Notes

Act Sec. 202(a) amended part VII of subchapter B of chapter 1 by redesignating Code Sec. 221 as Code Sec. 222 and by inserting after Code Sec. 220 a new Code Sec. 221 to read as above.

For the effective date of the above amendment, see Act Sec. 202(e), below.

Act Sec. 202(e) provides:

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to any qualified education loan (as defined in section 221(e)(1) of the Internal Revenue Code of 1986, as added by this section) incurred on, before, or after the date of the enactment of this Act, but only with respect to—

(1) any loan interest payment due and paid after December 31, 1997, and

(2) the portion of the 60-month period referred to in section 221(d) of the Internal Revenue Code of 1986 (as added by this section) after December 31, 1997.

[¶ 5091] CODE SEC. *222*. CROSS REFERENCE.

For deductions in respect of a decedent, see section 691.

* * *

[CCH Explanation at ¶ 157. Committee Reports at ¶ 10,145.]

Amendment Notes

Act Sec. 202(a) amended part VII of subchapter B of chapter 1 by redesignating Code Sec. 221 as Code Sec. 222.

For the effective date of the above amendment, see Act Sec. 202(e), below.

Act Sec. 202(e) provides:

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to any qualified education loan (as defined in section 221(e)(1) of the Internal Revenue Code of 1986, as added by this section) incurred on, before, or after the date of the enactment of this Act, but only with respect to—

(1) any loan interest payment due and paid after December 31, 1997, and

(2) the portion of the 60-month period referred to in section 221(d) of the Internal Revenue Code of 1986 (as added by this section) after December 31, 1997.

[¶ 5093] CODE SEC. 246. RULES APPLYING TO DEDUCTIONS FOR DIVIDENDS RECEIVED.

* * *

(c) EXCLUSION OF CERTAIN DIVIDENDS.—

(1) IN GENERAL.—No deduction shall be allowed under section 243, 244, or 245, in respect of any dividend on any share of stock—

(A) which is held by the taxpayer for 45 days or less during the 90-day period beginning on the date which is 45 days before the date on which such share becomes ex-dividend with respect to such dividend, or

(B) to the extent that the taxpayer is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

(2) 90-DAY RULE IN THE CASE OF CERTAIN PREFERENCE DIVIDENDS.—In the case of stock having preference in dividends, if the taxpayer receives dividends with respect to such stock which are attributable to a period or periods aggregating in excess of 366 days, paragraph (1)(A) shall be applied—

(A) by substituting "90 days" for "45 days" each place it appears, and

(B) by substituting "180-day period" for "90-day period".

(3) DETERMINATION OF HOLDING PERIODS.—For purposes of this subsection, in determining the period for which the taxpayer has held any share of stock—

(A) the day of disposition, but not the day of acquisition, shall be taken into account, *and*

(B) paragraph (4) of section 1223 shall not apply.

* * *

[CCH Explanation at ¶ 517. Committee Reports at ¶ 11,185.]

Amendment Notes

Act Sec. 1015(a) amended Code Sec. 246(c)(1)(A) to read as above. Prior to amendment, Code Sec. 246(c)(1)(A) read as follows:

(A) which is held by the taxpayer for 45 days or less or,

Act Sec. 1015(b)(1) amended Code Sec. 246(c)(2) to read as above. Prior to amendment, Code Sec. 246(c)(2) read as follows:

(2) 90-DAY RULE IN THE CASE OF CERTAIN PREFERENCE DIVIDENDS.—In the case of any stock having preference in dividends, the holding period specified in paragraph (1)(A) shall be 90 days in lieu of 45 days if the taxpayer receives dividends with respect to such stock which are attributable to a period or periods aggregating in excess of 366 days.

Act Sec. 1015(b)(2) amended Code Sec. 246(c)(3) by adding "and" at the end of subparagraph (A), by striking subparagraph (B), and by redesignating subparagraph (C) as subparagraph (B). Prior to being stricken, Code Sec. 246(c)(3)(B) read as follows:

(B) there shall not be taken into account any day which is more than 45 days (or 90 days in the case of stock to which paragraph (2) applies) after the date on which such share becomes ex-dividend, and

The above amendments generally apply to dividends received or accrued after the 30th day after the date of the enactment of this Act. For a transitional rule, see Act Sec. 1015(c)(2), below.

Act Sec. 1015(c)(2) provides:

(2) TRANSITIONAL RULE.—The amendments made by this section shall not apply to dividends received or accrued during the 2-year period beginning on the date of the enactment of this Act if—

(A) the dividend is paid with respect to stock held by the taxpayer on June 8, 1997, and all times thereafter until the dividend is received,

(B) such stock is continuously subject to a position described in section 246(c)(4) of the Internal Revenue Code of 1986 on June 8, 1997, and all times thereafter until the dividend is received, and

(C) such stock and position are clearly identified in the taxpayer's records within 30 days after the date of the enactment of this Act.

Stock shall not be treated as meeting the requirement of subparagraph (B) if the position is sold, closed, or otherwise terminated and reestablished.

[¶ 5095] CODE SEC. 263. CAPITAL EXPENDITURES.

(a) GENERAL RULE.—No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to—

(A) expenditures for the development of mines or deposits deductible under section 616,

(B) research and experimental expenditures deductible under section 174,

(C) soil and water conservation expenditures deductible under section 175,

(D) expenditures by farmers for fertilizer, etc., deductible under section 180,

(E) expenditures for removal of architectural and transportation barriers to the handicapped and elderly which the taxpayer elects to deduct under section 190,

(F) expenditures for tertiary injectants with respect to which a deduction is allowed under section 193;

(G) expenditures for which a deduction is allowed under section 179*; or*

(H) expenditures for which a deduction is allowed under section 179A.

* * *

Amendment Notes

Act Sec. 1604(a)(1) amended Code Sec. 263(a)(1) by striking "or" at the end of subparagraph (F), by striking the period at the end of subparagraph (G) and inserting "; or", and by adding at the end a new subparagraph (H) to read as above.

The above amendment is effective as if included in the amendments made by Act Sec. 1913 of the Energy Policy Act of 1992 (P.L. 102-486) [effective for property placed in service after June 30, 1993.—CCH.].

[¶ 5097] CODE SEC. 264. CERTAIN AMOUNTS PAID IN CONNECTION WITH INSURANCE CONTRACTS.

(a) GENERAL RULE.—No deduction shall be allowed for—

(1) Premiums on any life insurance policy, or endowment or annuity contract, if the taxpayer is directly or indirectly a beneficiary under the policy or contract.

* * *

(4) Except as provided in subsection (d), any interest paid or accrued on any indebtedness with respect to 1 or more life insurance policies owned by the taxpayer covering the life of any individual, or any endowment or annuity contracts owned by the taxpayer covering any *individual.*

* * *

Amendment Notes

Act Sec. 1084(a)(1) amended Code Sec. 264(a)(1) to read as above. Prior to amendment, Code Sec. 264(a)(1) read as follows:

(1) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

Act Sec. 1084(b)(1) amended Code Sec. 264(a)(4) by striking "individual, who" and all that follows and inserting "individual.". Prior to amendment, Code Sec. 264(a)(4) read as follows:

(4) Except as provided in subsection (d), any interest paid or accrued on any indebtedness with respect to 1 or more life insurance policies owned by the taxpayer covering the life of any individual, or any endowment or annuity contracts owned by the taxpayer covering any individual, who—

(A) is or was an officer or employee, or

(B) is or was financially interested in,

any trade or business carried on (currently or formerly) by the taxpayer.

For the effective date of the above amendments, see Act Sec. 1084(d)[(f)], below.

Act Sec. 1084(d)[(f)] provides:

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to contracts issued after June 8, 1997, in taxable years ending after such date. For purposes of the preceding sentence, any material increase in the death benefit or other material change in the contract shall be treated as a new contract but the addition of covered lives shall be treated as a new contract only with respect to such additional covered lives. For purposes of this subsection, an increase in the death benefit under a policy or contract issued in connection with a lapse described in section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 shall not be treated as a new contract.

Act Sec. 1602(f)(1) amended Code Sec. 264(a)(4) by striking subparagraph (A) and all that follows through "by the taxpayer." and inserting new subparagraphs (A) and (B) to read as above. Prior to amendment, Code Sec. 264(a)(4)(A) and the material that followed it read as follows:

(4) Except as provided in subsection (d), any interest paid or accrued on any indebtedness with respect to 1 or more life insurance policies owned by the taxpayer covering the life of any individual, or any endowment or annuity contracts owned by the taxpayer covering any individual, who—

(A) is an officer or employee of, or

(B) is financially interested in,

any trade or business carried on by the taxpayer.

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which it relates [generally effective for interest paid or accrued after October 13, 1995.—CCH.].

(b) EXCEPTIONS TO SUBSECTION (a)(1).—Subsection (a)(1) shall not apply to—

(1) any annuity contract described in section 72(s)(5), and

(2) any annuity contract to which section 72(u) applies.

Amendment Notes

Act Sec. 1084(a)(2) amended Code Sec. 264 by redesignating subsections (b), (c), and (d) as subsections (c), (d), and (e), respectively, and by inserting after subsection (a) a new subsection (b) to read as above.

For the effective date of the above amendment, see Act Sec. 1084(d)[(f)], in the amendment notes following Code Sec. 264(a), above.

(c) CONTRACTS TREATED AS SINGLE PREMIUM CONTRACTS.—For purposes of subsection (a) (2), a contract shall be treated as a single premium contract—

(1) if substantially all the premiums on the contract are paid within a period of 4 years from the date on which the contract is purchased, or

(2) if an amount is deposited after March 1, 1954, with the insurer for payment of a substantial number of future premiums on the contract.

Amendment Notes

Act Sec. 1084(a)(2) amended Code Sec. 264 by redesignating subsection (b) as subsection (c).

For the effective date of the above amendment, see Act Sec. 1084(d)[(f)], in the amendment notes following Code Sec. 264(a), above.

(d) EXCEPTIONS.—Subsection (a)(3) shall not apply to any amount paid or accrued by a person during a taxable year on indebtedness incurred or continued as part of a plan referred to in subsection (a)(3)—

(1) if no part of 4 of the annual premiums due during the 7-year period (beginning with the date the first premium on the contract to which such plan relates was paid) is paid under such plan by means of indebtedness,

(2) if the total of the amounts paid or accrued by such person during such taxable year for which (without regard to this paragraph) no deduction would be allowable by reason of subsection (a)(3) does not exceed $100,

(3) if such amount was paid or accrued on indebtedness incurred because of an unforeseen substantial loss of income or unforeseen substantial increase in his financial obligations, or

(4) if such indebtedness was incurred in connection with his trade or business.

For purposes of applying paragraph (1), if there is a substantial increase in the premiums on a contract, a new 7-year period described in such paragraph with respect to such contract shall commence on the date the first such increased premium is paid.

Amendment Notes

Act Sec. 1084(a)(2) amended Code Sec. 264 by redesignating subsection (c) as subsection (d).

For the effective date of the above amendment, see Act Sec. 1084(d)[(f)], in the amendment notes following Code Sec. 264(a), above.

(e) SPECIAL RULES FOR APPLICATION OF SUBSECTION (a)(4).—

* * *

(2) INTEREST RATE CAP ON KEY PERSONS AND PRE-1986 CONTRACTS.—

* * *

(B) APPLICABLE RATE OF INTEREST.—For purposes of subparagraph (A)—

* * *

(ii) PRE-1986 CONTRACTS.—In the case of indebtedness on a contract purchased on or before June 20, 1986—

(I) which is a contract providing a fixed rate of interest, the applicable rate of interest for any month shall be the Moody's rate described in clause (i) for the month in which the contract was purchased, or

(II) which is a contract providing a variable rate of interest, the applicable rate of interest for any month in an applicable period shall be such Moody's rate for the third month preceding the first month in such period.

For purposes of subclause (II), the term "applicable period" means the 12-month period beginning on the date the policy is issued (and each successive 12-month period thereafter) unless the taxpayer elects a number of months (not greater than 12) other than such 12-month period to be its applicable period. Such an election shall be made not later than the 90th day after the date of the enactment of this sentence and, if made, shall apply to the taxpayer's first taxable year ending on or after October 13, 1995, and all subsequent taxable years unless revoked with the consent of the Secretary.

* * *

(4) 20-PERCENT OWNER.—For purposes of this subsection, the term "20-percent owner" means—

(A) if the taxpayer is a corporation, any person who owns directly 20 percent or more of the outstanding stock of the corporation or stock possessing 20 percent or more of the total combined voting power of all stock of the corporation, or

(B) if the taxpayer is not a corporation, any person who owns 20 percent or more of the capital or profits interest in *the taxpayer.*

* * *

Amendment Notes

Act Sec. 1084(a)(2) amended Code Sec. 264 by redesignating subsection (d) as subsection (e).

For the effective date of the above amendment, see Act Sec. 1084(d)[(f)], in the amendment notes following Code Sec. 264(a), above.

Act Sec. 1602(f)(2) amended the last two sentences of Code Sec. 264(d)(2)(B)(ii) to read as above. Prior to amendment, the last two sentences of Code Sec. 264(d)(2)(B)(ii) read as follows:

For purposes of subclause (II), the taxpayer shall elect an applicable period for such contract on its return of tax imposed by this chapter for its first taxable year ending on or after October 13, 1995. Such applicable period shall be for any number of months (not greater than 12) specified in the election and may not be changed by the taxpayer without the consent of the Secretary.

Act Sec. 1602(f)(3) amended Code Sec. 264(d)(4)(B) by striking "the employer" and inserting "the taxpayer".

The above amendments are effective as if included in the provisions of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which they relate [generally effective for interest paid or accrued after October 13, 1995.—CCH.].

(f) PRO RATA ALLOCATION OF INTEREST EXPENSE TO POLICY CASH VALUES.—

(1) IN GENERAL.—No deduction shall be allowed for that portion of the taxpayer's interest expense which is allocable to unborrowed policy cash values.

(2) ALLOCATION.—For purposes of paragraph (1), the portion of the taxpayer's interest expense which is allocable to unborrowed policy cash values is an amount which bears the same ratio to such interest expense as—

(A) the taxpayer's average unborrowed policy cash values of life insurance policies, and annuity and endowment contracts, issued after June 8, 1997, bears to

(B) the sum of—

(i) in the case of assets of the taxpayer which are life insurance policies or annuity or endowment contracts, the average unborrowed policy cash values of such policies and contracts, and

(ii) in the case of assets of the taxpayer not described in clause (i), the average adjusted bases (within the meaning of section 1016) of such assets.

(3) UNBORROWED POLICY CASH VALUE.—For purposes of this subsection, the term "unborrowed policy cash value" means, with respect to any life insurance policy or annuity or endowment contract, the excess of—

(A) the cash surrender value of such policy or contract determined without regard to any surrender charge, over

(B) the amount of any loan with respect to such policy or contract.

(4) EXCEPTION FOR CERTAIN POLICIES AND CONTRACTS.—

(A) POLICIES AND CONTRACTS COVERING 20-PERCENT OWNERS, OFFICERS, DIRECTORS, AND EMPLOYEES.—Paragraph (1) shall not apply to any policy or contract owned by an entity engaged in a trade or business if such policy or contract covers only 1 individual and if such individual is (at the time first covered by the policy or contract)—

(i) a 20-percent owner of such entity, or

(ii) an individual (not described in clause (i)) who is an officer, director, or employee of such trade or business.

A policy or contract covering a 20-percent owner of such entity shall not be treated as failing to meet the requirements of the preceding sentence by reason of covering the joint lives of such owner and such owner's spouse.

(B) CONTRACTS SUBJECT TO CURRENT INCOME INCLUSION.—Paragraph (1) shall not apply to any annuity contract to which section 72(u) applies.

(C) COORDINATION WITH PARAGRAPH (2).—Any policy or contract to which paragraph (1) does not apply by reason of this paragraph shall not be taken into account under paragraph (2).

(D) 20-PERCENT OWNER.—For purposes of subparagraph (A), the term "20-percent owner" has the meaning given such term by subsection (e)(4).

(5) EXCEPTION FOR POLICIES AND CONTRACTS HELD BY NATURAL PERSONS; TREATMENT OF PARTNERSHIPS AND S CORPORATIONS.—

(A) Policies and contracts held by natural persons.—

(i) In general.—This subsection shall not apply to any policy or contract held by a natural person.

(ii) Exception where business is beneficiary.—If a trade or business is directly or indirectly the beneficiary under any policy or contract, such policy or contract shall be treated as held by such trade or business and not by a natural person.

(iii) Special rules.—

(I) Certain trades or businesses not taken into account.—Clause (ii) shall not apply to any trade or business carried on as a sole proprietorship and to any trade or business performing services as an employee.

(II) Limitation on unborrowed cash value.—The amount of the unborrowed cash value of any policy or contract which is taken into account by reason of clause (ii) shall not exceed the benefit to which the trade or business is directly or indirectly entitled under the policy or contract.

(iv) Reporting.—The Secretary shall require such reporting from policyholders and issuers as is necessary to carry out clause (ii). Any report required under the preceding sentence shall be treated as a statement referred to in section 6724(d)(1).

(B) Treatment of partnerships and S corporations.—In the case of a partnership or S corporation, this subsection shall be applied at the partnership and corporate levels.

(6) Special rules.—

(A) Coordination with subsection (a) and section 265.—If interest on any indebtedness is disallowed under subsection (a) or section 265—

(i) such disallowed interest shall not be taken into account for purposes of applying this subsection, and

(ii) the amount otherwise taken into account under paragraph (2)(B) shall be reduced (but not below zero) by the amount of such indebtedness.

(B) Coordination with section 263A.—This subsection shall be applied before the application of section 263A (relating to capitalization of certain expenses where taxpayer produces property).

(7) Interest expense.—The term "interest expense" means the aggregate amount allowable to the taxpayer as a deduction for interest (within the meaning of section 265(b)(4)) for the taxable year (determined without regard to this subsection, section 265(b), and section 291).

(8) Aggregation rules.—

(A) In general.—All members of a controlled group (within the meaning of subsection (d)(5)(B)) shall be treated as 1 taxpayer for purposes of this subsection.

(B) Treatment of insurance companies.—This subsection shall not apply to an insurance company subject to tax under subchapter L, and subparagraph (A) shall be applied without regard to any member of an affiliated group which is an insurance company.

[CCH Explanation at ¶ 845, 851 and 854. Committee Reports at ¶ 11,530, 13,850 and 13,855.]

Amendment Notes

Act Sec. 1084(c) amended Code Sec. 264 by adding at the end a new subsection (f) to read as above.

For the effective date of the above amendment, see Act Sec. 1084(d)[(f)] in the amendment notes following Code Sec 264(a), above.

[¶ 5099] CODE SEC. 265. EXPENSES AND INTEREST RELATING TO TAX-EXEMPT INCOME.

* * *

(b) Pro Rata Allocation of Interest Expense of Financial Institutions to Tax-Exempt Interest.—

* * *

(4) Definitions.—For purposes of this subsection—

(A) Interest expense.—The term "interest expense" means the aggregate amount allowable to the taxpayer as a deduction for interest for the taxable year (determined without regard to this subsection, *section 264,* and section 291). For purposes of the preceding sentence, the term "interest" includes amounts (whether or not designated as interest) paid in respect of deposits, investment certificates, or withdrawable or repurchasable shares.

* * *

[CCH Explanation at ¶ 845. Committee Reports at ¶ 11,530.]

Amendment Notes

Act Sec. 1084(c)[(e)] amended Code Sec. 265(b)(4)(A) by inserting ", section 264," before "and section 291".

For the effective date of the above amendment, see Act Sec. 1084(d)[(f)], below.

Act Sec. 1084(d)[(f)] provides:

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to contracts issued after June 8, 1997, in taxable years ending after such date. For purposes of the preceding sentence, any material increase in the death benefit or other material change in the contract shall be treated as a new contract but the addition of covered lives shall be treated as a new contract only with respect to such additional covered lives. For purposes of this subsection, an increase in the death benefit under a policy or contract issued in connection with a lapse described in section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 shall not be treated as a new contract.

[¶ 5101] CODE SEC. 267. LOSSES, EXPENSES, AND INTEREST WITH RESPECT TO TRANSACTIONS BETWEEN RELATED TAXPAYERS.

* * *

(b) RELATIONSHIPS.—The persons referred to in subsection (a) are:

* * *

(11) An S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation;

(12) An S corporation and a C corporation, if the same persons own more than 50 percent in value of the outstanding stock of each corporation*; or*

(13) Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.

* * *

Amendment Notes

Act Sec. 1308(a) amended Code Sec. 267(b) by striking "or" at the end of paragraph (11), by striking the period at the end of paragraph (12) and inserting "; or", and by adding at the end a new paragraph (13) to read as above.

The above amendment applies to tax years beginning after the date of the enactment of this Act.

(f) CONTROLLED GROUP DEFINED; SPECIAL RULES APPLICABLE TO CONTROLLED GROUPS.—

* * *

(4) DETERMINATION OF RELATIONSHIP RESULTING IN DISALLOWANCE OF LOSS, FOR PURPOSES OF OTHER PROVISIONS.—For purposes of any other section of this title which refers to a relationship which would result in a disallowance of losses under this section, deferral under paragraph (2) shall be treated as disallowance.

* * *

[CCH Explanation at ¶ 270 and 521. Committee Reports at ¶ 12,650 and 13,950.]

Amendment Notes

Act Sec. 1604(e)(1) amended Code Sec. 267(f) by adding at the end a new paragraph (4) to read as above.

The above amendment is effective as if included in Act Sec. 174(b) of the Tax Reform Act of 1984 (P.L. 98-369) [generally effective for transactions after December 31, 1983, in tax years ending after such date.—CCH.].

[¶ 5103] CODE SEC. 274. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES.

* * *

(n) ONLY 50 PERCENT OF MEAL AND ENTERTAINMENT EXPENSES ALLOWED AS DEDUCTION.—

* * *

(3) SPECIAL RULE FOR INDIVIDUALS SUBJECT TO FEDERAL HOURS OF SERVICE.—

(A) IN GENERAL.—In the case of any expenses for food or beverages consumed while away from home (within the meaning of section 162(a)(2)) by an individual during, or incident to, the period of duty subject to the hours of service limitations of the Department of Transportation, paragraph (1) shall be applied by substituting "the applicable percentage" for "50 percent".

(B) APPLICABLE PERCENTAGE.—For purposes of this paragraph, the term "applicable percentage" means the percentage determined under the following table:

For taxable years beginning in calendar year—	*The applicable percentage is—*
1998 or 1999	*55*
2000 or 2001	*60*
2002 or 2003	*65*
2004 or 2005	*70*
2006 or 2007	*75*
2008 or thereafter	*80*

* * *

[CCH Explanation at ¶ 111. Committee Reports at ¶ 10,875.]

Amendment Notes

Act Sec. 969(a) amended Code Sec. 274(n) by adding at the end a new paragraph (3) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5107] CODE SEC. 280A. DISALLOWANCE OF CERTAIN EXPENSES IN CONNECTION WITH BUSINESS USE OF HOME, RENTAL OF VACATION HOMES, ETC.

* * *

(c) EXCEPTIONS FOR CERTAIN BUSINESS OR RENTAL USE; LIMITATION ON DEDUCTIONS FOR SUCH USE.—

[*Caution: Code Sec. 280A(c)(1), below, as amended by Act Sec. 932(a) of the Taxpayer Relief Act of 1997, applies to tax years beginning after December 31, 1998.—CCH.*]

(1) CERTAIN BUSINESS USE.—Subsection (a) shall not apply to any item to the extent such item is allocable to a portion of the dwelling unit which is exclusively used on a regular basis—

(A) as the principal place of business for any trade or business of the taxpayer,

(B) as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or business, or

(C) in the case of a separate structure which is not attached to the dwelling unit, in connection with the taxpayer's trade or business.

In the case of an employee, the preceding sentence shall apply only if the exclusive use referred to in the preceding sentence is for the convenience of his employer. *For purposes of subparagraph (A), the term "principal place of business" includes a place of business which is used by the taxpayer for the administrative or management activities of any trade or business of the taxpayer if there is no other fixed location of such trade or business where the taxpayer conducts substantial administrative or management activities of such trade or business.*

* * *

Amendment Notes

Act Sec. 932(a) amended Code Sec. 280A(c)(1) by adding at the end a new sentence to read as above.

The above amendment applies to tax years beginning after December 31, 1998.

(d) USE AS RESIDENCE.—

* * *

(4) RENTAL OF PRINCIPAL RESIDENCE.—

(A) IN GENERAL.—For purposes of applying subsection (c)(5) to deductions allocable to a qualified rental period, a taxpayer shall not be considered to have used a dwelling unit for personal purposes for any day during the taxable year which occurs before or after a qualified rental period described in subparagraph (B)(i), or before a qualified rental period described in subparagraph (B)(ii), if with respect to such day such unit constitutes the principal residence (within the meaning of *section 121*) of the taxpayer.

* * *

[CCH Explanation at ¶ 109 and 129. Committee Reports at ¶ 10,315 and 10,660.]

Amendment Notes

Act Sec. 312(d)(1) amended Code Sec. 280A(d)(4)(A) by striking "section 1034" and inserting "section 121".

For the effective date of the above amendment, see Act Sec. 312(d)[(e)], below.

Act Sec. 312(d)[(e)] provides:

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to sales and exchanges after May 6, 1997.

(2) SALES BEFORE DATE OF ENACTMENT.—At the election of the taxpayer, the amendments made by this section shall not

apply to any sale or exchange before the date of the enactment of this Act.

(3) CERTAIN SALES WITHIN 2 YEARS AFTER DATE OF ENACTMENT.—Section 121 of the Internal Revenue Code of 1986 (as amended by this section) shall be applied without regard to subsection (c)(2)(B) thereof in the case of any sale or exchange of property during the 2-year period beginning on the date of the enactment of this Act if the taxpayer held such property on the date of the enactment of this Act and fails to meet the ownership and use requirements of subsection (a) thereof with respect to such property.

(4) BINDING CONTRACTS.—At the election of the taxpayer, the amendments made by this section shall not apply to a sale or exchange after the date of the enactment of this Act, if—

(A) such sale or exchange is pursuant to a contract which was binding on such date, or

(B) without regard to such amendments, gain would not be recognized under section 1034 of the Internal Revenue Code of 1986 (as in effect on the day before the date of the enactment of this Act) on such sale or exchange by reason of a new residence acquired on or before such date or with respect to the acquisition of which by the taxpayer a binding contract was in effect on such date.

This paragraph shall not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) of the Internal Revenue Code of 1986 applies to such individual.

[¶ 5109] CODE SEC. 280F. LIMITATION ON DEPRECIATION FOR LUXURY AUTOMOBILES; LIMITATION WHERE CERTAIN PROPERTY USED FOR PERSONAL PURPOSES.

(a) LIMITATION ON AMOUNT OF DEPRECIATION FOR LUXURY AUTOMOBILES.—

(1) DEPRECIATION.—

* * *

[*Caution: Code Sec. 280F(a)(1)(C), below, as added by Act Sec. 971(a) of the Taxpayer Relief Act of 1997, applies to property placed in service after the date of the enactment of the Act and before January 1, 2005.—CCH.*]

(C) SPECIAL RULE FOR CERTAIN CLEAN-FUEL PASSENGER AUTOMOBILES.—

(i) MODIFIED AUTOMOBILES.—In the case of a passenger automobile which is propelled by a fuel which is not a clean-burning fuel and to which is installed qualified clean-fuel vehicle property (as defined in section 179A(c)(1)(A)) for purposes of permitting such vehicle to be propelled by a clean burning fuel (as defined in section 179A(e)(1)), subparagraph (A) shall not apply to the cost of the installed qualified clean burning vehicle property.

(ii) PURPOSE BUILT PASSENGER VEHICLES.—In the case of a purpose built passenger vehicle (as defined in section 4001(a)(2)(C)(ii)), each of the annual limitations specified in subparagraph (A) shall be tripled.

* * *

[CCH Explanation at ¶ 327. Committee Reports at ¶ 10,885.]

Amendment Notes

Act Sec. 971(a) amended Code Sec. 280F(a)(1) by adding at the end a new subparagraph (C) to read as above.

The above amendment applies to property placed in service after the date of the enactment of this Act and before January 1, 2005.

[¶ 5111] CODE SEC. 304. REDEMPTION THROUGH USE OF RELATED CORPORATIONS.

(a) TREATMENT OF CERTAIN STOCK PURCHASES.—

(1) ACQUISITION BY RELATED CORPORATION (OTHER THAN SUBSIDIARY).—For purposes of sections 302 and 303, if—

(A) one or more persons are in control of each of two corporations, and

(B) in return for property, one of the corporations acquires stock in the other corporation from the person (or persons) so in control,

then (unless paragraph (2) applies) such property shall be treated as a distribution in redemption of the stock of the corporation acquiring such stock. *To the extent that such distribution is treated as a distribution to which section 301 applies, the transferor and the acquiring corporation shall be treated in the same manner as if the transferor had transferred the stock so acquired to the acquiring corporation in exchange for stock of the acquiring corporation in a transaction to which section 351(a) applies, and then the acquiring corporation had redeemed the stock it was treated as issuing in such transaction.*

* * *

Amendment Notes

Act Sec. 1013(a) amended the last sentence of Code Sec. 304(a)(1) to read as above. Prior to amendment, the last sentence of Code Sec. 304(a)(1) read as follows:

To the extent that such distribution is treated as a distribution to which section 301 applies, the stock so acquired shall be treated as having been transferred by the person from whom acquired, and as having been received by the corporation acquiring it, as a contribution to the capital of such corporation.

The above amendment generally applies to distributions and acquisitions after June 8, 1997. For a transition rule, see Act Sec. 1013(d)(2), below.

Act Sec. 1013(d)(2) provides:

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any distribution or acquisition after June 8, 1997, if such distribution or acquisition is—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described in a public announcement or filing with the Securities and Exchange Commission on or before such date.

(b) SPECIAL RULES FOR APPLICATION OF SUBSECTION (a).—

* * *

(5) ACQUISITIONS BY FOREIGN CORPORATIONS.—

(A) IN GENERAL.—In the case of any acquisition to which subsection (a) applies in which the acquiring corporation is a foreign corporation, the only earnings and profits taken into account under paragraph (2)(A) shall be those earnings and profits—

(i) which are attributable (under regulations prescribed by the Secretary) to stock of the acquiring corporation owned (within the meaning of section 958(a)) by a corporation or individual which is—

(I) a United States shareholder (within the meaning of section 951(b)) of the acquiring corporation, and

(II) the transferor or a person who bears a relationship to the transferor described in section 267(b) or 707(b), and

(ii) which were accumulated during the period or periods such stock was owned by such person while the acquiring corporation was a controlled foreign corporation.

(B) APPLICATION OF SECTION 1248.—For purposes of subparagraph (A), the rules of section 1248(d) shall apply except to the extent otherwise provided by the Secretary.

(C) REGULATIONS.—The Secretary shall prescribe such regulations as are appropriate to carry out the purposes of this paragraph.

* * *

[CCH Explanation at ¶ 505. Committee Reports at ¶ 11,175.]

Amendment Notes

Act Sec. 1013(c) amended Code Sec. 304(b) by adding at the end a new paragraph (5) to read as above.

The above amendment generally applies to distributions and acquisitions after June 8, 1997. For a transition rule, see Act Sec. 1013(d)(2), below.

Act Sec. 1013(d)(2) provides:

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any distribution or acquisition after June 8, 1997, if such distribution or acquisition is—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described in a public announcement or filing with the Securities and Exchange Commission on or before such date.

[¶ 5113] CODE SEC. 312. EFFECT ON EARNINGS AND PROFITS.

* * *

(k) EFFECT OF DEPRECIATION ON EARNINGS AND PROFITS.—

* * *

(3) EXCEPTION FOR TANGIBLE PROPERTY.—

* * *

(B) TREATMENT OF AMOUNTS DEDUCTIBLE UNDER SECTION *179 OR 179A*.—For purposes of computing the earnings and profits of a corporation, any amount deductible under section *179 or 179A* shall be allowed as a deduction ratably over the period of 5 taxable years (beginning with the taxable year for which such amount is deductible under section *179 or 179A, as the case may be*).

* * *

Amendment Notes

Act Sec. 1604(a)(2)(A)-(B) amended Code Sec. 312(k)(3)(B) by striking "179" in the heading and the first place it appears in the text and inserting "179 or 179A", and by striking "179" the last place it appears and inserting "179 or 179A, as the case may be".

The above amendment is effective as if included in the amendments made by Act Sec. 1913 of the Energy Policy Act of 1992 (P.L. 102-486) [effective for property placed in service after June 30, 1993.—CCH.].

[¶ 5115] CODE SEC. 318. CONSTRUCTIVE OWNERSHIP OF STOCK.

* * *

(b) CROSS REFERENCES.—

For provisions to which the rules contained in subsection (a) apply, see—

* * *

(8) section *6038(d)[(e)](2)* (relating to information with respect to certain foreign corporations).

* * *

[CCH Explanation at ¶ 983. Committee Reports at ¶ 11,760.]

Amendment Notes

Act Sec. 1142(e)(3) amended Code Sec. 318(b)(8) by striking "6038(d)(1)" and inserting "6038(d)(2)".

The above amendment applies to annual accounting periods beginning after the date of the enactment of this Act.

[¶ 5117] CODE SEC. 351. TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.

* * *

(c) SPECIAL RULES WHERE DISTRIBUTION TO SHAREHOLDERS.—In determining control for purposes of this section—

(1) the fact that any corporate transferor distributes part or all of the stock in the corporation which it receives in the exchange to its shareholders shall not be taken into account, and

(2) if the requirements of section 355 are met with respect to such distribution, the shareholders shall be treated as in control of such corporation immediately after the exchange if the shareholders own (immediately after the distribution) stock possessing—

(A) more than 50 percent of the total combined voting power of all classes of stock of such corporation entitled to vote, and

(B) more than 50 percent of the total value of shares of all classes of stock of such corporation.

* * *

Amendment Notes

Act Sec. 1012(c)(1) amended Code Sec. 351(c) to read as above. Prior to amendment, Code Sec. 351(c) read as follows:

(c) SPECIAL RULE.—In determining control, for purposes of this section, the fact that any corporate transferor distributes part or all of the stock which it receives in the exchange to its shareholders shall not be taken into account.

The above amendment generally applies to transfers after the date of the enactment of this Act. For a transition rule, see Act Sec. 1012(d)(3), below.

Act Sec. 1012(d)(3), provides:

(3) TRANSITION RULE.—The amendments made by this section shall not apply to any distribution pursuant to a plan (or series of related transactions) which involves an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 (or, in the case of the amendments made by subsection (c), any transfer) occurring after April 16, 1997, if such acquisition or transfer is—

(A) made pursuant to an agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the acquisition or transfer.

This paragraph shall not apply to any agreement, ruling request, or public announcement or filing unless it identifies the acquirer of the distributing corporation or any controlled corporation, or the transferee, whichever is applicable.

(e) EXCEPTIONS.—This section shall not apply to—

(1) TRANSFER OF PROPERTY TO AN INVESTMENT COMPANY.—A transfer of property to an investment company. *For purposes of the preceding sentence, the determination of whether a company is an investment company shall be made—*

(A) by taking into account all stock and securities held by the company, and

(B) by treating as stock and securities—

(i) money,

(ii) stocks and other equity interests in a corporation, evidences of indebtedness, options, forward or futures contracts, notional principal contracts and derivatives,

(iii) any foreign currency,

(iv) any interest in a real estate investment trust, a common trust fund, a regulated investment company, a publicly-traded partnership (as defined in section 7704(b)) or any other equity interest (other than in a corporation) which pursuant to its terms or any other

arrangement is readily convertible into, or exchangeable for, any asset described in any preceding clause, this clause or clause (v) or (viii),

(v) except to the extent provided in regulations prescribed by the Secretary, any interest in a precious metal, unless such metal is used or held in the active conduct of a trade or business after the contribution,

(vi) except as otherwise provided in regulations prescribed by the Secretary, interests in any entity if substantially all of the assets of such entity consist (directly or indirectly) of any assets described in any preceding clause or clause (viii),

(vii) to the extent provided in regulations prescribed by the Secretary, any interest in any entity not described in clause (vi), but only to the extent of the value of such interest that is attributable to assets listed in clauses (i) through (v) or clause (viii), or

(viii) any other asset specified in regulations prescribed by the Secretary.

The Secretary may prescribe regulations that, under appropriate circumstances, treat any asset described in clauses (i) through (v) as not so listed.

* * *

Amendment Notes

Act Sec. 1002(a) amended Code Sec. 351(e)(1) by adding at the end new material to read as above. Prior to amendment, Code Sec. 351(e)(1) read as follows:

(1) TRANSFER OF PROPERTY TO AN INVESTMENT COMPANY.—A transfer of property to an investment company.

The above amendment generally applies to transfers after June 8, 1997, in tax years ending after such date. For a special rule, see Act Sec. 1002(b)(2), below.

Act Sec. 1002(b)(2), provides:

(2) BINDING CONTRACTS.—The amendment made by subsection (a) shall not apply to any transfer pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such transfer if such contract provides for the transfer of a fixed amount of property.

(g) NONQUALIFIED PREFERRED STOCK NOT TREATED AS STOCK.—

(1) IN GENERAL.—In the case of a person who transfers property to a corporation and receives nonqualified preferred stock—

(A) subsection (a) shall not apply to such transferor,

(B) subsection (b) shall apply to such transferor, and

(C) such nonqualified preferred stock shall be treated as other property for purposes of applying subsection (b).

(2) NONQUALIFIED PREFERRED STOCK.—For purposes of paragraph (1)—

(A) IN GENERAL.—The term "nonqualified preferred stock" means preferred stock if—

(i) the holder of such stock has the right to require the issuer or a related person to redeem or purchase the stock,

(ii) the issuer or a related person is required to redeem or purchase such stock,

(iii) the issuer or a related person has the right to redeem or purchase the stock and, as of the issue date, it is more likely than not that such right will be exercised, or

(iv) the dividend rate on such stock varies in whole or in part (directly or indirectly) with reference to interest rates, commodity prices, or other similar indices.

(B) LIMITATIONS.—Clauses (i), (ii), and (iii) of subparagraph (A) shall apply only if the right or obligation referred to therein may be exercised within the 20-year period beginning on the issue date of such stock and such right or obligation is not subject to a contingency which, as of the issue date, makes remote the likelihood of the redemption or purchase.

(C) EXCEPTIONS FOR CERTAIN RIGHTS OR OBLIGATIONS.—

(i) IN GENERAL.—A right or obligation shall not be treated as described in clause (i), (ii), or (iii) of subparagraph (A) if—

(I) it may be exercised only upon the death, disability, or mental incompetency of the holder, or

(II) in the case of a right or obligation to redeem or purchase stock transferred in connection with the performance of services for the issuer or a related person (and which represents reasonable compensation), it may be exercised only upon the holder's separation from service from the issuer or a related person.

(ii) EXCEPTION.—Clause (i)(I) shall not apply if the stock relinquished in the exchange, or the stock acquired in the exchange is in—

(I) a corporation if any class of stock in such corporation or a related party is readily tradable on an established securities market or otherwise, or

(II) any other corporation if such exchange is part of a transaction or series of transactions in which such corporation is to become a corporation described in subclause (I).

(3) DEFINITIONS.—For purposes of this subsection—

(A) PREFERRED STOCK.—The term "preferred stock" means stock which is limited and preferred as to dividends and does not participate in corporate growth to any significant extent.

(B) RELATED PERSON.—A person shall be treated as related to another person if they bear a relationship to such other person described in section 267(b) or 707(b).

(4) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection and sections 354(a)(2)(C), 355(a)(3)(D), and 356(e). The Secretary may also prescribe regulations, consistent with the treatment under this subsection and such sections, for the treatment of nonqualified preferred stock under other provisions of this title.

Amendment Notes

Act Sec. 1014(a) amended Code Sec. 351 by redesignating subsection (g) as subsection (h), and by inserting after subsection (f) a new subsection (g) to read as above.

The above amendment generally applies to transactions after June 8, 1997. For a transition rule, see Act Sec. 1014(f)(2), below.

Act Sec. 1014(f)(2) provides:

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any transaction after June 8, 1997, if such transaction is—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the transaction.

(h) CROSS REFERENCES.—

* * *

[CCH Explanation at ¶ 503, 507 and 509. Committee Reports at ¶ 11,125, 11,170 and 11,180.]

Amendment Notes

Act Sec. 1014(a) amended Code Sec. 351 by redesignating subsection (g) as subsection (h).

The above amendment generally applies to transactions after June 8, 1997. For a transitional rule, see Act Sec. 1014(f)(2), below.

Act Sec. 1014(f)(2), provides:

(f) EFFECTIVE DATE.—

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any transaction after June 8, 1997, if such transaction is—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the transaction.

[¶ 5119] CODE SEC. 354. EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS.

(a) GENERAL RULE.—

* * *

(2) LIMITATIONS.—

* * *

(B) PROPERTY ATTRIBUTABLE TO ACCRUED INTEREST.—Neither paragraph (1) nor so much of section 356 as relates to paragraph (1) shall apply to the extent that any stock *(including nonqualified preferred stock, as defined in section 351(g)(2))*, securities, or other property received is attributable to interest which has accrued on securities on or after the beginning of the holder's holding period.

(C) NONQUALIFIED PREFERRED STOCK.—

(i) IN GENERAL.—Nonqualified preferred stock (as defined in section 351(g)(2)) received in exchange for stock other than nonqualified preferred stock (as so defined) shall not be treated as stock or securities.

(ii) RECAPITALIZATIONS OF FAMILY-OWNED CORPORATIONS.—

(I) IN GENERAL.—Clause (i) shall not apply in the case of a recapitalization under section 368(a)(1)(E) of a family-owned corporation.

(II) FAMILY-OWNED CORPORATION.—For purposes of this clause, except as provided in regulations, the term "family-owned corporation" means any corporation which is described in clause (i) of section 447(d)(2)(C) throughout the 8-year period beginning on the date which is 5 years before the date of the recapitalization. For purposes of the preceding sentence, stock shall not be treated as owned by a family member during any period described in section 355(d)(6)(B).

(3) CROSS REFERENCES.—

(A) For treatment of the exchange if any property is received which is not permitted to be received under this subsection (including *nonqualified preferred stock and* an excess principal amount of securities received over securities surrendered, but not including property to which paragraph (2)(B) applies), see section 356.

* * *

[CCH Explanation at ¶ 507. Committee Reports at ¶ 11,180.]

Amendment Notes

Act Sec. 1014(b) amended Code Sec. 354(a)(2) by adding at the end a new subparagraph (C) to read as above.

Act Sec. 1014(e)(1) amended Code Sec. 354(a)(2)(B) by inserting "(including nonqualified preferred stock, as defined in section 351(g)(2))" after "stock".

Act Sec. 1014(e)(2) amended Code Sec. 354(a)(3)(A) by inserting "nonqualified preferred stock and" after "including".

The above amendments generally apply to transactions after June 8, 1997. For a transitional rule, see Act Sec. 1014(f)(2), below.

Act Sec. 1014(f)(2) provides:

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any transaction after June 8, 1997, if such transaction is—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the transaction.

[¶ 5121] CODE SEC. 355. DISTRIBUTION OF STOCK AND SECURITIES OF A CONTROLLED CORPORATION.

(a) EFFECT ON DISTRIBUTEES.—

* * *

(3) LIMITATIONS.—

* * *

(C) PROPERTY ATTRIBUTABLE TO ACCRUED INTEREST.—Neither paragraph (1) nor so much of section 356 as relates to paragraph (1) shall apply to the extent that any stock *(including nonqualified preferred stock, as defined in section 351(g)(2)),* securities, or other property received is attributable to interest which has accrued on securities on or after the beginning of the holder's holding period.

(D) NONQUALIFIED PREFERRED STOCK.—Nonqualified preferred stock (as defined in section 351(g)(2)) received in a distribution with respect to stock other than nonqualified preferred stock (as so defined) shall not be treated as stock or securities.

(4) CROSS REFERENCES.—

(A) For treatment of the exchange if any property is received which is not permitted to be received under this subsection (including *nonqualified preferred stock and* an excess principal amount of securities received over securities surrendered, but not including property to which paragraph (3)(C) applies), see section 356.

* * *

Amendment Notes

Act Sec. 1014(c) amended Code Sec. 355(a)(3) by adding at the end a new subparagraph (D) to read as above.

Act Sec. 1014(e)(1) amended Code Sec. 355(a)(3)(C) by inserting "(including nonqualified preferred stock, as defined in section 351(g)(2))" after "stock".

Act Sec. 1014(e)(2) amended Code Sec. 355(a)(4)(A) by inserting "nonqualified preferred stock and" after "including".

The above amendments generally apply to transactions after June 8, 1997. For a transitional rule, see Act Sec. 1014(f)(2), below.

Act Sec. 1014(f)(2) provides:

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any transaction after June 8, 1997, if such transaction is—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the transaction.

(e) Recognition of Gain on Certain Distributions of Stock or Securities In Connection With Acquisitions.—

(1) General rule.—If there is a distribution to which this subsection applies, any stock or securities in the controlled corporation shall not be treated as qualified property for purposes of subsection (c)(2) of this section or section 361(c)(2).

(2) Distributions to which subsection applies.—

(A) In general.—This subsection shall apply to any distribution—

(i) to which this section (or so much of section 356 as relates to this section) applies, and

(ii) which is part of a plan (or series of related transactions) pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation.

(B) Plan presumed to exist in certain cases.—If 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation during the 4-year period beginning on the date which is 2 years before the date of the distribution, such acquisition shall be treated as pursuant to a plan described in subparagraph (A)(ii) unless it is established that the distribution and the acquisition are not pursuant to a plan or series of related transactions.

(C) Certain plans disregarded.—A plan (or series of related transactions) shall not be treated as described in subparagraph (A)(ii) if, immediately after the completion of such plan or transactions, the distributing corporation and all controlled corporations are members of a single affiliated group (as defined in section 1504 without regard to subsection (b) thereof).

(D) Coordination with subsection (d).—This subsection shall not apply to any distribution to which subsection (d) applies.

(3) Special rules relating to acquisitions.—

(A) Certain acquisitions not taken into account.—Except as provided in regulations, the following acquisitions shall not be treated as described in paragraph (2)(A)(ii):

(i) The acquisition of stock in any controlled corporation by the distributing corporation.

(ii) The acquisition by a person of stock in any controlled corporation by reason of holding stock or securities in the distributing corporation.

(iii) The acquisition by a person of stock in any successor corporation of the distributing corporation or any controlled corporation by reason of holding stock or securities in such distributing or controlled corporation.

(iv) The acquisition of stock in a corporation if shareholders owning directly or indirectly stock possessing—

(I) more than 50 percent of the total combined voting power of all classes of stock entitled to vote, and

(II) more than 50 percent of the total value of shares of all classes of stock,

in the distributing corporation or any controlled corporation before such acquisition own directly or indirectly stock possessing such vote and value in such distributing or controlled corporation after such acquisition.

This subparagraph shall not apply to any acquisition if the stock held before the acquisition was acquired pursuant to a plan (or series of related transactions) described in paragraph (2)(A)(ii).

(B) Asset acquisitions.—Except as provided in regulations, for purposes of this subsection, if the assets of the distributing corporation or any controlled corporation are acquired by a successor corporation in a transaction described in subparagraph (A), (C), or (D) of section 368(a)(1) or any other transaction specified in regulations by the Secretary, the shareholders (immediately before the acquisition) of the corporation acquiring such assets shall be treated as acquiring stock in the corporation from which the assets were acquired.

(4) Definition and special rules.—For purposes of this subsection—

(A) 50-percent or greater interest.—The term "50-percent or greater interest" has the meaning given such term by subsection (d)(4).

(B) Distributions in title 11 or similar case.—Paragraph (1) shall not apply to any distribution made in a title 11 or similar case (as defined in section 368(a)(3)).

(C) Aggregation and attribution rules.—

(i) AGGREGATION.—The rules of paragraph (7)(A) of subsection (d) shall apply.

(ii) ATTRIBUTION.—Section 318(a)(2) shall apply in determining whether a person holds stock or securities in any corporation. Except as provided in regulations, section 318(a)(2)(C) shall be applied without regard to the phrase "50 percent or more in value" for purposes of the preceding sentence.

(D) SUCCESSORS AND PREDECESSORS.—For purposes of this subsection, any reference to a controlled corporation or a distributing corporation shall include a reference to any predecessor or successor of such corporation.

(E) STATUTE OF LIMITATIONS.—If there is a distribution to which paragraph (1) applies—

(i) the statutory period for the assessment of any deficiency attributable to any part of the gain recognized under this subsection by reason of such distribution shall not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may by regulations prescribe) that such distribution occurred, and

(ii) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

(5) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including regulations—

(A) providing for the application of this subsection where there is more than 1 controlled corporation,

(B) treating 2 or more distributions as 1 distribution where necessary to prevent the avoidance of such purposes, and

(C) providing for the application of rules similar to the rules of subsection (d)(6) where appropriate for purposes of paragraph (2)(B).

Amendment Notes

Act Sec. 1012(a) amended Code Sec. 355 by adding at the end a new subsection (e) to read as above.

The above amendment generally applies to distributions after April 16, 1997, pursuant to a plan (or series of related transactions) which involves an acquisition described in Code Sec. 355(e)(2)(A)(ii) occurring after such date. For a transitional rule, see Act Sec. 1012(d)(3), below.

Act Sec. 1012(d)(3) provides:

(3) TRANSITION RULE.—The amendments made by this section shall not apply to any distribution pursuant to a plan (or series of related transactions) which involves an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 (or, in the case of the amendments made by subsection (c), any transfer) occurring after April 16, 1997, if such acquisition or transfer is—

(A) made pursuant to an agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the acquisition or transfer.

This paragraph shall not apply to any agreement, ruling request, or public announcement or filing unless it identifies the acquirer of the distributing corporation or any controlled corporation, or the transferee, whichever is applicable.

(f) SECTION NOT TO APPLY TO CERTAIN INTRAGROUP DISTRIBUTIONS.—Except as provided in regulations, this section (or so much of section 356 as relates to this section) shall not apply to the distribution of stock from 1 member of an affiliated group (as defined in section 1504(a)) to another member of such group if such distribution is part of a plan (or series of related transactions) described in subsection (e)(2)(A)(ii) (determined after the application of subsection (e)).

[CCH Explanation at ¶ 503 and 507. Committee Reports at ¶ 11,170 and 11,180.]

Amendment Notes

Act Sec. 1012(b)(1) amended Code Sec. 355, as amended by Act Sec. 1012(a), by adding at the end a new subsection (f) to read as above.

The above amendment generally applies to distributions after April 16, 1997, pursuant to a plan (or series of related transactions) which involves an acquisition described in Code Sec. 355(e)(2)(A)(ii) occurring after such date. For a transitional rule, see Act Sec. 1012(d)(3) in the amendment notes following Code Sec. 355(e), above.

[¶ 5123] CODE SEC. 356. RECEIPT OF ADDITIONAL CONSIDERATION.

* * *

(e) NONQUALIFIED PREFERRED STOCK TREATED AS OTHER PROPERTY.—For purposes of this section—

(1) IN GENERAL.—Except as provided in paragraph (2), the term "other property" includes nonqualified preferred stock (as defined in section 351(g)(2)).

(2) Exception.—The term "other property" does not include nonqualified preferred stock (as so defined) to the extent that, under section 354 or 355, such preferred stock would be permitted to be received without the recognition of gain.

Amendment Notes

Act Sec. 1014(d) amended Code Sec. 356 by redesignating subsections (e) and (f) as subsections (f) and (g), respectively, and by inserting after subsection (d) a new subsection (e) to read as above.

The above amendment generally applies to transactions after June 8, 1997. For a transition rule, see Act Sec. 1014(f)(2), below.

Act Sec. 1014(f)(2) provides:

(2) Transition rule.—The amendments made by this section shall not apply to any transaction after June 8, 1997, if such transaction is—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the transaction.

(f) Exchanges for Section 306 Stock.—Notwithstanding any other provision of this section, to the extent that any of the other property (or money) is received in exchange for section 306 stock, an amount equal to the fair market value of such other property (or the amount of such money) shall be treated as a distribution of property to which section 301 applies.

Amendment Notes

Act Sec. 1014(d) amended Code Sec. 356 by redesignating subsection (e) as subsection (f).

The above amendment generally applies to transactions after June 8, 1997. For a transition rule, see Act Sec. 1014(f)(2), below.

Act Sec. 1014(f)(2) provides:

(2) Transition rule.—The amendments made by this section shall not apply to any transaction after June 8, 1997, if such transaction is—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the transaction.

(g) Transactions Involving Gift or Compensation.—

For special rules for a transaction described in section 354, 355, or this section, but which—

(1) results in a gift, see section 2501 and following, or

(2) has the effect of the payment of compensation, see section 61(a)(1).

* * *

[CCH Explanation at ¶ 507. Committee Reports at ¶ 11,180.]

Amendment Notes

Act Sec. 1014(d) amended Code Sec. 356 by redesignating subsection (f) as subsection (g).

The above amendment generally applies to transactions after June 8, 1997. For a transition rule, see Act Sec. 1014(f)(2), below.

Act Sec. 1014(f)(2), provides:

(2) Transition rule.—The amendments made by this section shall not apply to any transaction after June 8, 1997, if such transaction is—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the transaction.

[¶ 5125] CODE SEC. 358. BASIS TO DISTRIBUTEES.

* * *

(g) Adjustments in Intragroup Transactions Involving Section 355.—In the case of a distribution to which section 355 (or so much of section 356 as relates to section 355) applies and which involves the distribution of stock from 1 member of an affiliated group (as defined in section 1504(a) without regard to subsection (b) thereof) to another member of such group, the Secretary may, notwithstanding any other provision of this section, provide adjustments to the adjusted basis of any stock which—

(1) is in a corporation which is a member of such group, and

(2) is held by another member of such group, to appropriately reflect the proper treatment of such distribution.

* * *

[CCH Explanation at ¶ 503. Committee Reports at ¶ 11,170.]

Amendment Notes

Act Sec. 1012(b)(2) amended Code Sec. 358 by adding at the end a new subsection (g) to read as above.

The above amendment generally applies to distributions after April 16, 1997, pursuant to a plan (or a series of related transactions) which involves an acquisition described in section 355(e)(2)(A)(ii) of the Internal Reve-

nue Code of 1986 occurring after such date. For a transitional rule, see Act Sec. 1012(d)(3), below.

Act Sec. 1012(d)(3), provides:

(3) TRANSITION RULE.—The amendments made by this section shall not apply to any distribution pursuant to a plan (or series of related transactions) which involves an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 (or, in the case of the amendments made by subsection (c), any transfer) occurring after April 16, 1997, if such acquisition or transfer is—

(A) made pursuant to an agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the acquisition or transfer.

This paragraph shall not apply to any agreement, ruling request, or public announcement or filing unless it identifies the acquirer of the distributing corporation or any controlled corporation, or the transferee, whichever is applicable.

[¶ 5127] CODE SEC. 367. FOREIGN CORPORATIONS.

* * *

(d) SPECIAL RULES RELATING TO TRANSFERS OF INTANGIBLES.—

* * *

(2) TRANSFER OF INTANGIBLES TREATED AS TRANSFER PURSUANT TO SALE OF CONTINGENT PAYMENTS.—

* * *

(C) AMOUNTS RECEIVED TREATED AS ORDINARY INCOME.—For purposes of this chapter, any amount included in gross income by reason of this subsection shall be treated as ordinary income.

(3) REGULATIONS RELATING TO TRANSFERS OF INTANGIBLES TO PARTNERSHIPS.—The Secretary may provide by regulations that the rules of paragraph (2) also apply to the transfer of intangible property by a United States person to a partnership in circumstances consistent with the purposes of this subsection.

* * *

Amendment Notes

Act Sec. 1131(b)[(c)](4) amended Code Sec. 367(d)(2)(C) to read as above. Prior to amendment, Code Sec. 367(d)(2)(C) read as follows:

(C) AMOUNTS RECEIVED TREATED AS UNITED STATES SOURCE ORDINARY INCOME.—For purposes of this chapter, any amount included in gross income by reason of this subsection shall be treated as ordinary income from sources within the United States.

Act Sec. 1131(b)[(c)](5)(A) amended Code Sec. 367(d) by adding at the end a new paragraph (3) to read as above.

The above amendments are effective on the date of the enactment of this Act.

(f) OTHER TRANSFERS.—To the extent provided in regulations, if a United States person transfers property to a foreign corporation as paid-in surplus or as a contribution to capital (in a transaction not otherwise described in this section), such transfer shall be treated as a sale or exchange for an amount equal to the fair market value of the property transferred, and the transferor shall recognize as gain the excess of—

(1) the fair market value of the property so transferred, over

(2) the adjusted basis (for purposes of determining gain) of such property in the hands of the transferor.

[CCH Explanation at ¶ 968 and 969. Committee Reports at ¶ 11,735.]

Amendment Notes

Act Sec. 1131(b)[(c)](2) amended Code Sec. 367 by adding at the end a new subsection (f) to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5129] CODE SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) REORGANIZATION.—

* * *

(2) SPECIAL RULES RELATING TO PARAGRAPH (1).—

* * *

(H) SPECIAL RULES FOR DETERMINING WHETHER CERTAIN TRANSACTIONS ARE QUALIFIED UNDER PARAGRAPH (1)(D).—For purposes of determining whether a transaction qualifies under paragraph (1)(D)—

(i) in the case of a transaction with respect to which the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met, the term "control" has the meaning given such term by section 304(c), and

(ii) in the case of a transaction with respect to which the requirements of section 355 are met, the shareholders described in paragraph (1)(D) shall be treated as having control of the corporation to which the assets are transferred if such shareholders own (immediately after the distribution) stock possessing—

(I) more than 50 percent of the total combined voting power of all classes of stock of such corporation entitled to vote, and

(II) more than 50 percent of the total value of shares of all classes of stock of such corporation.

* * *

[CCH Explanation at ¶ 503. Committee Reports at ¶ 11,170.]

Amendment Notes

Act Sec. 1012(c)(2) amended Code Sec. 368(a)(2)(H) to read as above. Prior to amendment, Code Sec. 368(a)(2)(H) read as follows:

(H) SPECIAL RULE FOR DETERMINING WHETHER CERTAIN TRANSACTIONS ARE QUALIFIED UNDER PARAGRAPH (1)(D).—In the case of any transaction with respect to which the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met, for purposes of determining whether such transaction qualifies under subparagraph (D) of paragraph (1), the term "control" has the meaning given to such term by section 304(c).

The above amendment generally applies to transfers after the date of the enactment of this Act. For a transitional rule, see Act Sec. 1012(d)(3), below.

Act Sec. 1012(d)(3) provides:

(3) TRANSITION RULE.—The amendments made by this section shall not apply to any distribution pursuant to a plan (or series of related transactions) which involves an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 (or, in the case of the amendments made by subsection (c), any transfer) occurring after April 16, 1997, if such acquisition or transfer is—

(A) made pursuant to an agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the acquisition or transfer.

This paragraph shall not apply to any agreement, ruling request, or public announcement or filing unless it identifies the acquirer of the distributing corporation or any controlled corporation, or the transferee, whichever is applicable.

[¶ 5131] CODE SEC. 401. QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS.

(a) REQUIREMENTS FOR QUALIFICATION.—A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section—

(1) if contributions are made to the trust by such employer, or employees, or both, or by another employer who is entitled to deduct his contributions under section 404(a)(3)(B) (relating to deduction for contributions to profit-sharing and stock bonus plans), *or by a charitable remainder trust pursuant to a qualified gratuitous transfer (as defined in section 664(g)(1)),* for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with such plan;

* * *

(5) SPECIAL RULES RELATING TO NONDISCRIMINATION REQUIREMENTS.—

* * *

(G) STATE AND LOCAL GOVERNMENTAL PLANS.—Paragraphs (3) and (4) shall not apply to a governmental plan (within the meaning of section 414(d)) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof).

* * *

(13) ASSIGNMENT AND ALIENATION.—

* * *

(C) SPECIAL RULE FOR CERTAIN JUDGMENTS AND SETTLEMENTS.—Subparagraph (A) shall not apply to any offset of a participant's benefits provided under a plan against an amount that the participant is ordered or required to pay to the plan if—

(i) the order or requirement to pay arises—

(I) under a judgment of conviction for a crime involving such plan,

(II) under a civil judgment (including a consent order or decree) entered by a court in an action brought in connection with a violation (or alleged violation) of part 4 of subtitle B of title I of the Employee Retirement Income Security Act of 1974, or

(III) pursuant to a settlement agreement between the Secretary of Labor and the participant, or a settlement agreement between the Pension Benefit Guaranty Corporation and the participant, in connection with a violation (or alleged violation) of part 4 of such subtitle by a fiduciary or any other person,

(ii) the judgment, order, decree, or settlement agreement expressly provides for the offset of all or part of the amount ordered or required to be paid to the plan against the participant's benefits provided under the plan, and

(iii) in a case in which the survivor annuity requirements of section 401(a)(11) apply with respect to distributions from the plan to the participant, if the participant has a spouse at the time at which the offset is to be made—

(I) either such spouse has consented in writing to such offset and such consent is witnessed by a notary public or representative of the plan (or it is established to the satisfaction of a plan representative that such consent may not be obtained by reason of circumstances described in section 417(a)(2)(B)), or an election to waive the right of the spouse to either a qualified joint and survivor annuity or a qualified preretirement survivor annuity is in effect in accordance with the requirements of section 417(a),

(II) such spouse is ordered or required in such judgment, order, decree, or settlement to pay an amount to the plan in connection with a violation of part 4 of such subtitle, or

(III) in such judgment, order, decree, or settlement, such spouse retains the right to receive the survivor annuity under a qualified joint and survivor annuity provided pursuant to section 401(a)(11)(A)(i) and under a qualified preretirement survivor annuity provided pursuant to section 401(a)(11)(A)(ii), determined in accordance with subparagraph (D).

A plan shall not be treated as failing to meet the requirements of this subsection, subsection (k), section 403(b), or section 409(d) solely by reason of an offset described in this subparagraph.

(D) SURVIVOR ANNUITY.—

(i) IN GENERAL.—The survivor annuity described in subparagraph (C)(iii)(III) shall be determined as if—

(I) the participant terminated employment on the date of the offset,

(II) there was no offset,

(III) the plan permitted commencement of benefits only on or after normal retirement age,

(IV) the plan provided only the minimum-required qualified joint and survivor annuity, and

(V) the amount of the qualified preretirement survivor annuity under the plan is equal to the amount of the survivor annuity payable under the minimum-required qualified joint and survivor annuity.

(ii) DEFINITION.—For purposes of this subparagraph, the term "minimum-required qualified joint and survivor annuity" means the qualified joint and survivor annuity which is the actuarial equivalent of the participant's accrued benefit (within the meaning of section 411(a)(7)) and under which the survivor annuity is 50 percent of the amount of the annuity which is payable during the joint lives of the participant and the spouse.

* * *

(26) ADDITIONAL PARTICIPATION REQUIREMENTS.—

* * *

(H) EXCEPTION FOR STATE AND LOCAL GOVERNMENTAL PLANS.—This paragraph shall not apply to a governmental plan (within the meaning of section 414(d)) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof).

* * *

Amendment Notes

Act Sec. 1502(b) amended Code Sec. 401(a)(13) by adding at the end new subparagraphs (C)-(D) to read as above.

The above amendment applies to judgments, orders, and decrees issued, and settlement agreements entered into, on or after the date of the enactment of this Act.

Act Sec. 1505(a)(1) amended Code Sec. 401(a)(5) by adding at the end a new subparagraph (G) to read as above.

Act Sec. 1505(a)(2) amended Code Sec. 401(a)(26)(H) to read as above. Prior to amendment, Code Sec. 401(a)(26)(H) read as follows:

(H) SPECIAL RULE FOR CERTAIN POLICE OR FIREFIGHTERS.—

(i) IN GENERAL.—An employer may elect to have this paragraph applied separately with respect to any classification of qualified public safety employees for whom a separate plan is maintained.

(ii) QUALIFIED PUBLIC SAFETY EMPLOYEE.—For purposes of this subparagraph, the term "qualified public safety employee" means any employee of any police department or fire department organized and operated by a State or political subdivision if the employee provides police protection, firefighting services, or emergency medical services for any area within the jurisdiction of such State or political subdivision.

The above amendments apply to tax years beginning on or after the date of enactment of this Act. For a special rule, see Act Sec. 1505(d)(2), below.

Act Sec. 1505(d)(2) provides:

(2) TREATMENT FOR YEARS BEGINNING BEFORE DATE OF ENACTMENT.—A governmental plan (within the meaning of section 414(d) of the Internal Revenue Code of 1986) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof) shall be treated as satisfying the requirements of sections 401(a)(3), 401(a)(4), 401(a)(26), 401(k), 401(m), 403(b)(1)(D) and (b)(12), and 410 of such Code for all taxable years beginning before the date of enactment of this Act.

Act Sec. 1530(c)(1) amended Code Sec. 401(a)(1) by inserting "or by a charitable remainder trust pursuant to a qualified gratuitous transfer (as defined in section 664(g)(1)), after "stock bonus plans),".

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

(k) CASH OR DEFERRED ARRANGEMENTS.—

* * *

(3) APPLICATION OF PARTICIPATION AND DISCRIMINATION STANDARDS.—

* * *

(G) A governmental plan (within the meaning of section 414(d)) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof) shall be treated as meeting the requirements of this paragraph.

* * *

(7) RURAL COOPERATIVE PLAN.—For purposes of this subsection—

* * *

(B) RURAL COOPERATIVE DEFINED.—For purposes of subparagraph (A), the term "rural cooperative" means—

(i) any organization which—

(I) is engaged primarily in providing electric service on a mutual or cooperative basis, or

(II) is engaged primarily in providing electric service to the public in its area of service and which is exempt from tax under this subtitle or which is a State or local government (or an agency or instrumentality thereof), other than a municipality (or an agency or instrumentality thereof),

(ii) any organization described in paragraph (4) or (6) of section 501(c) and at least 80 percent of the members of which are organizations described in clause (i),

(iii) a cooperative telephone company described in section 501(c)(12),

(iv) any organization which—

(I) is a mutual irrigation or ditch company described in section 501(c)(12) (without regard to the 85 percent requirement thereof), or

(II) is a district organized under the laws of a State as a municipal corporation for the purpose of irrigation, water conservation, or drainage, and

(v) an organization which is a national association of organizations described in clause (i), (ii),, [sic] *(iii), or (iv).*

* * *

(11) ADOPTION OF SIMPLE PLAN TO MEET NONDISCRIMINATION TESTS.—

* * *

(B) CONTRIBUTION REQUIREMENTS.—

* * *

(iii) ADMINISTRATIVE REQUIREMENTS.—

(I) IN GENERAL.—Rules similar to the rules of subparagraphs (B) and (C) of section 408(p)(5) shall apply for purposes of this subparagraph.

(II) NOTICE OF ELECTION PERIOD.—The requirements of this subparagraph shall not be treated as met with respect to any year unless the employer notifies each employee eligible to participate, within a reasonable period of time before the 60th day before the

beginning of such year (and, for the first year the employee is so eligible, the 60th day before the first day such employee is so eligible), of the rules similar to the rules of section 408(p)(5)(C) which apply by reason of subclause (I).

* * *

(D) DEFINITIONS AND SPECIAL RULE.—

* * *

(ii) COORDINATION WITH TOP-HEAVY RULES.—A plan meeting the requirements of this paragraph for any year shall not be treated as a top-heavy plan under section 416 for such year *if such plan allows only contributions required under this paragraph.*

(E) COST-OF-LIVING ADJUSTMENT.—The Secretary shall adjust the $6,000 amount under subparagraph (B)(i)(I) at the same time and in the same manner as under section 408(p)(2)(E).

* * *

Amendment Notes

Act Sec. 1505(b) amended Code Sec. 401(k)(3) by adding at the end a new subparagraph (G) to read as above.

The above amendment applies to tax years beginning on or after the date of enactment of this Act. For a special rule, see Act Sec. 1505(d)(2), below.

Act Sec. 1505(d)(2) provides:

(2) TREATMENT FOR YEARS BEGINNING BEFORE DATE OF ENACTMENT.—A governmental plan (within the meaning of section 414(d) of the Internal Revenue Code of 1986) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof) shall be treated as satisfying the requirements of sections 401(a)(3), 401(a)(4), 401(a)(26), 401(k), 401(m), 403(b)(1)(D) and (b)(12), and 410 of such Code for all taxable years beginning before the date of enactment of this Act.

Act Sec. 1525(a)(1)-(2) amended Code Sec. 401(k)(7)(B) by striking "and" at the end of clause (iii), by redesignating clause (iv) as clause (v), by inserting after clause (iii) a new clause (iv) to read as above, and by striking "or (iii)" in clause (v), as so redesignated, and inserting ", (iii), or (iv)".

The above amendment applies to years beginning after December 31, 1997.

Act Sec. 1601(d)(2)(A) amended Code Sec. 401(k)(11)(D)(ii) by striking the period and inserting "if such plan allows only contributions required under this paragraph.".

Act Sec. 1601(d)(2)(B) amended Code Sec. 401(k)(11) by adding at the end a new subparagraph (E) to read as above.

The above amendments are effective as if included in the provisions of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which they relate [effective for plan years beginning after December 31, 1996.—CCH.].

Act Sec. 1601(d)(2)(D) amended Code Sec. 401(k)(11)(B) by adding at the end a new clause (iii) to read as above.

The above amendment applies to calendar years beginning after the date of the enactment of this Act.

(m) NONDISCRIMINATION TEST FOR MATCHING CONTRIBUTIONS AND EMPLOYEE CONTRIBUTIONS.—

* * *

[*Caution: Code Sec. 401(m)(11), below, as added by P.L. 104-188 and amended by Act Sec. 1601(d)(3) of the Taxpayer Relief Act of 1997, applies to years beginning after December 31, 1998.—CCH.*]

(11) *ADDITIONAL ALTERNATIVE* METHOD OF SATISFYING TESTS.—

* * *

[CCH Explanation at ¶ 703, 731, 745, 747, 749 and 758. Committee Reports at ¶ 13,225, 13,255, 13,375, 13,435, 13,595, 13,615 and 13,625.]

Amendment Notes

Act Sec. 1601(d)(3) amended Code Sec. 401(m)(11) by striking "ALTERNATIVE" and inserting "ADDITIONAL ALTERNATIVE" in the heading.

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for years beginning after December 31, 1998.—CCH.].

[¶ 5133] CODE SEC. 402. TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST.

* * *

(g) LIMITATION ON EXCLUSION FOR ELECTIVE DEFERRALS.—

* * *

(9) MATCHING CONTRIBUTIONS ON BEHALF OF SELF-EMPLOYED INDIVIDUALS NOT TREATED AS ELECTIVE EMPLOYER CONTRIBUTIONS.—Except as provided in section 401(k)(3)(D)(ii), any matching contribution described in section 401(m)(4)(A) which is made on behalf of a self-employed individual (as defined in section 401(c)) shall not be treated as an elective employer contribution under a qualified cash or deferred arrangement (as defined in section 401(k)) for purposes of this title.

* * *

[CCH Explanation at ¶ 729. Committee Reports at ¶ 13,215.]

Amendment Notes

Act Sec. 1501(a) amended Code Sec. 402(g) by adding at the end a new paragraph (9) to read as above.

The above amendment applies to years beginning after December 31, 1997.

[¶ 5135] CODE SEC. 403. TAXATION OF EMPLOYEE ANNUITIES.

* * *

(b) TAXABILITY OF BENEFICIARY UNDER ANNUITY PURCHASED BY Section 501(c)(3) ORGANIZATION OR PUBLIC SCHOOL.—

(1) GENERAL RULE.—If—

(A) an annuity contract is purchased—

(i) for an employee by an employer described in section 501(c)(3) which is exempt from tax under section 501(a),

(ii) for an employee (other than an employee described in clause (i)), who performs services for an educational organization described in section 170(b)(1)(A)(ii), by an employer which is a State, a political subdivision of a State, or an agency or instrumentality of any one or more of the foregoing, or

(iii) for the minister described in section 414(e)(5)(A) by the minister or by an employer,

* * *

(3) INCLUDIBLE COMPENSATION.—For purposes of this subsection, the term "includible compensation" means, in the case of any employee, the amount of compensation which is received from the employer described in paragraph (1)(A), and which is includible in gross income (computed without regard to section 911) for the most recent period (ending not later than the close of the taxable year) which under paragraph (4) may be counted as one year of service. Such term does not include any amount contributed by the employer for any annuity contract to which this subsection applies. *Such term includes—*

(A) any elective deferral (as defined in section 402(g)(3)), and

(B) any amount which is contributed or deferred by the employer at the election of the employee and which is not includible in the gross income of the employee by reason of section 125 or 457.

* * *

(12) NONDISCRIMINATION REQUIREMENTS.—

* * *

(C) STATE AND LOCAL GOVERNMENTAL PLANS.—For purposes of paragraph (1)(D), the requirements of subparagraph (A)(i) (other than those relating to section 401(a)(17)) shall not apply to a governmental plan (within the meaning of section 414(d)) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof).

* * *

[CCH Explanation at ¶ 758 and 776. Committee Reports at ¶ 13,245 and 13,255.]

Amendment Notes

Act Sec. 1504(a)(1) amended Code Sec. 403(b)(3) by adding at the end "Such term includes—" and the material that follows through the period at the end of the sentence to read as above.

The above amendment applies to years beginning after December 31, 1997.

Act Sec. 1504(b) provides:

(b) REPEAL OF RULES IN SECTION 415(c).—The Secretary of the Treasury shall modify the regulations regarding the exclusion allowance under section 403(b)(2) of the Internal Revenue Code of 1986 to reflect the amendment made by section 1452(a) of the Small Business Job Protection Act of 1996. Such modification shall take effect for years beginning after December 31, 1999.

Act Sec. 1505(b) amended Code Sec. 403(b)(12) by adding at the end a new subparagraph (C) to read as above.

The above amendment generally applies to tax years beginning on or after the date of enactment of this Act. For a special rule, see Act Sec. 1505(d)(2), below.

Act Sec. 1505(d)(2) provides:

(2) TREATMENT FOR YEARS BEGINNING BEFORE DATE OF ENACTMENT.—A governmental plan (within the meaning of section 414(d) of the Internal Revenue Code of 1986) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof) shall be treated as satisfying the requirements of sections 401(a)(3), 401(a)(4), 401(a)(26), 401(k), 401(m), 403(b)(1)(D) and (b)(12), and 410 of such Code for all taxable years beginning before the date of enactment of this Act.

Act Sec. 1601(d)(4) provides:

(4) CLARIFICATION OF SECTION 1450.—

(A) Section 403(b)(11) of the Internal Revenue Code of 1986 shall not apply with respect to a distribution from a contract described in section 1450(b)(1) of such Act to the extent that such distribution is not includible in income by reason of—

(i) in the case of distributions before January 1, 1998, section 403(b)(8) or 403(b)(10) of such Code (determined after the application of section 1450(b)(2) of such Act), and

(ii) in the case of distributions on and after such date, such section 403(b)(1).

(B) This paragraph shall apply as if included in section 1450 of the Small Business Job Protection Act of 1996.

Act Sec. 1601(d)(6)(B) amended Code Sec. 403(b)(1)(A) by striking "or" at the end of clause (i), by inserting "or" at the end of clause (ii), and by adding at the end a new clause (iii) to read as above.

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for years beginning after December 31, 1996.—CCH.].

[¶ 5137] CODE SEC. 404. DEDUCTION FOR CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OR ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED-PAYMENT PLAN.

(a) GENERAL RULE.—If contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under this chapter; but if they would otherwise be deductible, they shall be deductible under this section, subject, however, to the following limitations as to the amounts deductible in any year:

* * *

(3) STOCK BONUS AND PROFIT-SHARING TRUSTS.—

(A) LIMITS ON DEDUCTIBLE CONTRIBUTIONS.—

(i) IN GENERAL.—In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 501(a), in an amount *not in excess of the greater of—*

(I) 15 percent of the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the stock bonus or profit-sharing plan, or

(II) the amount such employer is required to contribute to such trust under section 401(k)(11) for such year.

(ii) CARRYOVER OF EXCESS CONTRIBUTIONS.—Any amount paid into the trust in any taxable year in excess of the limitation of clause (i) (or the corresponding provision of prior law) shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this clause in any 1 such succeeding taxable year together with the amount allowable under clause (i) shall not exceed *the amount described in subclause (I) or (II) of clause (i), whichever is greater, with respect to such taxable year.*

* * *

(9) CERTAIN CONTRIBUTIONS TO EMPLOYEE STOCK OWNERSHIP PLANS.—

* * *

(C)[(D)] A qualified gratuitous transfer (as defined in section 664(g)(1)) shall have no effect on the amount or amounts otherwise deductible under paragraph (3) or (7) or under this paragraph.

* * *

[CCH Explanation at ¶ 284 and 743. Committee Reports at ¶ 13,435 and 13,620.]

Amendment Notes

Act Sec. 1530(c)(2) amended Code Sec. 404(a)(9) by inserting after subparagraph (B) a new subparagraph (C)[(D)] to read as above.

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

Act Sec. 1601(d)(2)(C)(i) amended Code Sec. 404(a)(3)(A)(i) by striking "not in excess of" and all that follows and inserting "not in excess of the greater of—" and new subclauses (I) and (II) to read as above. Prior to amendment, Code Sec. 404(a)(3)(A)(i) read as follows:

(i) IN GENERAL.—In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 501(a), in an amount not in excess of 15 percent of the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the stock bonus or profit-sharing plan.

Act Sec. 1601(d)(2)(C)(ii) amended Code Sec. 404(a)(3)(A)(ii) by striking "15 percent" and all that follows and inserting "the amount described in subclause (I) or (II) of clause (i), whichever is greater, with respect to such taxable year.". Prior to amendment, Code Sec. 404(a)(3)(A)(ii) read as follows:

(ii) CARRYOVER OF EXCESS CONTRIBUTIONS.—Any amount paid into the trust in any taxable year in excess of the limitation of clause (i) (or the corresponding provision of prior law) shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this clause in any 1 such succeeding taxable year together with the amount allowable under clause (i) shall not exceed 15 percent of the compensation otherwise paid or accrued during such taxable year to the beneficiaries under the plan.

The above amendments are effective as if included in the provisions of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which they relate [effective for plan years beginning after December 31, 1996.—CCH.].

[¶ 5139] CODE SEC. 408. INDIVIDUAL RETIREMENT ACCOUNTS.

* * *

(i) REPORTS.—The trustee of an individual retirement account and the issuer of an endowment contract described in subsection (b) or an individual retirement annuity shall make such reports regarding such account, contract, or annuity to the Secretary and to the individuals for whom the account, contract, or annuity is, or is to be, maintained with respect to contributions (and the years to which they relate), distributions aggregating $10 or more in any calendar year, and such other matters as the Secretary may require. The reports required by this subsection—

(1) shall be filed at such time and in such manner as the Secretary prescribes, and

(2) shall be furnished to individuals—

(A) not later than January 31 of the calendar year following the calendar year to which such reports relate, and

(B) in such manner as the Secretary prescribes.

In the case of a simple retirement account under subsection (p), only one report under this subsection shall be required to be submitted each calendar year to the Secretary (at the time provided under paragraph (2)) but, in addition to the report under this subsection, there shall be furnished, within *31 days* after each calendar year, to the individual on whose behalf the account is maintained a statement with respect to the account balance as of the close of, and the account activity during, such calendar year.

* * *

Amendment Notes

Act Sec. 302(d)(1)-(2) amended Code Sec. 408(i)(1)-(2) by striking "under regulations" following "as the Secretary may require", and by striking "in such regulations" each place it appears. Prior to amendment, Code Sec. 408(i)(1)-(2) read as follows

(i) REPORTS.—The trustee of an individual retirement account and the issuer of an endowment contract described in subsection (b) or an individual retirement annuity shall make such reports regarding such account, contract, or annuity to the Secretary and to the individuals for whom the account, contract, or annuity is, or is to be, maintained with respect to contributions (and the years to which they relate), distributions aggregating $10 or more in any calendar year, and such other matters as the Secretary may require under regulations. The reports required by this subsection—

(1) shall be filed at such time and in such manner as the Secretary prescribes in such regulations, and

(2) shall be furnished to individuals—

(A) not later than January 31 of the calendar year following the calendar year to which such reports relate, and

(B) in such manner as the Secretary prescribes in such regulations.

The above amendment applies to tax years beginning after December 31, 1997.

Act Sec. 1601(d)(1)(A) amended Code Sec. 408(i) by striking "30 days" in the last sentence and inserting "31 days".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

(k) SIMPLIFIED EMPLOYEE PENSION DEFINED.—

* * *

(6) EMPLOYEE MAY ELECT SALARY REDUCTION ARRANGEMENT.—

* * *

(H) TERMINATION.—This paragraph shall not apply to years beginning after December 31, 1996. The preceding sentence shall not apply to a simplified employee pension *of an employer if the terms of simplified employee pensions of such employer*, as in effect on December 31, 1996, provide that an employee may make the election described in subparagraph (A).

* * *

Amendment Notes

Act Sec. 1601(d)(1)(B) amended Code Sec. 408(k)(6)(H) by striking "if the terms of such pension" and inserting "of an employer if the terms of simplified employee pensions of such employer".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

(l) SIMPLIFIED EMPLOYER REPORTS.—

* * *

(2) SIMPLE RETIREMENT ACCOUNTS.—

* * *

(B) SUMMARY DESCRIPTION.—The trustee of any simple retirement account established pursuant to a qualified salary reduction arrangement under subsection (p) *and the issuer of an annuity established under such an arrangement* shall provide to the employer maintaining the arrangement, each year a description containing the following information:

(i) The name and address of the employer and the trustee *or issuer.*

(ii) The requirements for eligibility for participation.

(iii) The benefits provided with respect to the arrangement.

(iv) The time and method of making elections with respect to the arrangement.

(v) The procedures for, and effects of, withdrawals (including rollovers) from the arrangement.

* * *

Amendment Notes

Act Sec. 1601(d)(1)(C)(i)(I)-(II) amended Code Sec. 408(l)(2)(B) by inserting "and the issuer of an annuity established under such an arrangement" after "under subsection (p)", and by inserting in clause (i) "or issuer" after "trustee".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

(m) INVESTMENT IN COLLECTIBLES TREATED AS DISTRIBUTIONS.—

* * *

(3) EXCEPTION FOR CERTAIN COINS AND BULLION.—For purposes of this subsection, the term "collectible" shall not include—

(A) any coin which is—

(i) a gold coin described in paragraph (7), (8), (9), or (10) of section 5112(a) of title 31, United States Code,

(ii) a silver coin described in section 5112(e) of title 31, United States Code,

(iii) a platinum coin described in section 5112(k) of title 31, United States Code, or

(iv) a coin issued under the laws of any State, or

(B) any gold, silver, platinum, or palladium bullion of a fineness equal to or exceeding the minimum fineness that a contract market (as described in section 7 of the Commodity Exchange Act, 7 U.S.C. 7) requires for metals which may be delivered in satisfaction of a regulated futures contract,

if such bullion is in the physical possession of a trustee described under subsection (a) of this section.

* * *

Amendment Notes

Act Sec. 304(a) amended Code Sec. 408(m)(3) to read as above. Prior to amendment, Code Sec. 408(m)(3) read as follows:

(3) EXCEPTION FOR CERTAIN COINS.—In the case of an individual retirement account, paragraph (2) shall not apply to—

(A) any gold coin described in paragraph (7), (8), (9), or (10) of section 5112(a) of title 31,

(B) any silver coin described in section 5112(e) of title 31, or

(C) any coin issued under the laws of any State.

The above amendment applies to tax years beginning after December 31, 1997.

(p) SIMPLE RETIREMENT ACCOUNTS.—

* * *

(2) QUALIFIED SALARY REDUCTION ARRANGEMENT.—

* * *

(D) ARRANGEMENT MAY BE ONLY PLAN OF EMPLOYER.—

(i) IN GENERAL.—An arrangement shall not be treated as a qualified salary reduction arrangement for any year if the employer (or any predecessor employer) maintained a qualified plan with respect to which contributions were made, or benefits were accrued, for service in any year in the period beginning with the year such arrangement became effective and ending with the year for which the determination is being made. *If only individuals other than employees described in subparagraph (A) or (B) of section 410(b)(3) are eligible to participate in such arrangement, then the preceding sentence shall be applied without regard to any qualified plan in which only employees so described are eligible to participate.*

* * *

(iii) GRACE PERIOD.—In the case of an employer who establishes and maintains a plan under this subsection for 1 or more years and who fails to meet any requirement of this subsection for any subsequent year due to any acquisition, disposition, or similar

transaction involving another such employer, rules similar to the rules of section 410(b)(6)(C) shall apply for purposes of this subsection.

* * *

(5) ADMINISTRATIVE REQUIREMENTS.—The requirements of this paragraph are met with respect to any *simple* retirement account if, under the qualified salary reduction arrangement—

(A) an employer must—

(i) make the elective employer contributions under paragraph (2)(A)(i) not later than the close of the 30-day period following the last day of the month with respect to which the contributions are to be made, and

(ii) make the matching contributions under paragraph (2)(A)(iii) or the nonelective contributions under paragraph (2)(B) not later than the date described in section 404(m)(2)(B),

(B) an employee may elect to terminate participation in such arrangement at any time during the year, except that if an employee so terminates, the arrangement may provide that the employee may not elect to resume participation until the beginning of the next year, and

(C) each employee eligible to participate may elect, during the 60-day period before the beginning of any year (and the 60-day period before the first day such employee is eligible to participate), to participate in the arrangement, or to modify the amounts subject to such arrangement, for such year.

* * *

(8) COORDINATION WITH MAXIMUM LIMITATION UNDER SUBSECTION (a).—In the case of any simple retirement account, subsections (a)(1) and (b)(2) shall be applied by substituting "the sum of the dollar amount in effect under paragraph (2)(A)(ii) of this subsection and the employer contribution required under subparagraph (A)(iii) or (B)(i) of paragraph (2) of this subsection, whichever is applicable" for "$2,000".

(8)[(9)] MATCHING CONTRIBUTIONS ON BEHALF OF SELF-EMPLOYED INDIVIDUALS NOT TREATED AS ELECTIVE EMPLOYER CONTRIBUTIONS.—Any matching contribution described in paragraph (2)(A)(iii) which is made on behalf of a self-employed individual (as defined in section 401(c)) shall not be treated as an elective employer contribution to a simple retirement account for purposes of this title.

* * *

[CCH Explanation at ¶ 166, 180, 729, 735, 737, 739, 740, 741 and 785. Committee Reports at ¶ 10,260, 10,270, 13,215, 13,555, 13,560, 13,565, 13,570, 13,580 and 13,590.]

Amendment Notes

Act Sec. 1501(b) amended Code Sec. 408(p) by adding at the end a new paragraph (8)[(9)] to read as above.

The above amendment applies to years beginning after December 31, 1996.

Act Sec. 1601(d)(1)(D) amended Code Sec. 408(p) by adding at the end a new paragraph (8) to read as above.

Act Sec. 1601(d)(1)(E) amended Code Sec. 408(p)(2)(D)(i) by adding at the end a new sentence to read as above.

Act Sec. 1601(d)(1)(F) amended Code Sec. 408(p)(2)(D) by adding at the end a new clause (iii) to read as above.

Act Sec. 1601(d)(1)(G) amended Code Sec. 408(p)(5) by striking "simplified" and inserting "simple" in the text preceding subparagraph (A).

The above amendments are effective as if included in the provisions of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which they relate [effective for tax years beginning after December 31, 1996.—CCH.].

[¶ 5141] *CODE SEC. 408A. ROTH IRAS.*

(a) GENERAL RULE.—Except as provided in this section, a Roth IRA shall be treated for purposes of this title in the same manner as an individual retirement plan.

(b) ROTH IRA.—For purposes of this title, the term "Roth IRA" means an individual retirement plan (as defined in section 7701(a)(37)) which is designated (in such manner as the Secretary may prescribe) at the time of establishment of the plan as a Roth IRA. Such designation shall be made in such manner as the Secretary may prescribe.

(c) TREATMENT OF CONTRIBUTIONS.—

(1) NO DEDUCTION ALLOWED.—No deduction shall be allowed under section 219 for a contribution to a Roth IRA.

(2) CONTRIBUTION LIMIT.—The aggregate amount of contributions for any taxable year to all Roth IRAs maintained for the benefit of an individual shall not exceed the excess (if any) of—

(A) the maximum amount allowable as a deduction under section 219 with respect to such individual for such taxable year (computed without regard to subsection (d)(1) or (g) of such section), over

(B) the aggregate amount of contributions for such taxable year to all other individual retirement plans (other than Roth IRAs) maintained for the benefit of the individual.

(3) LIMITS BASED ON MODIFIED ADJUSTED GROSS INCOME.—

(A) DOLLAR LIMIT.—The amount determined under paragraph (2) for any taxable year shall be reduced (but not below zero) by the amount which bears the same ratio to such amount as—

(i) the excess of—

(I) the taxpayer's adjusted gross income for such taxable year, over

(II) the applicable dollar amount, bears to

(ii) $15,000 ($10,000 in the case of a joint return).

The rules of subparagraphs (B) and (C) of section 219(g)(2) shall apply to any reduction under this subparagraph.

(B) ROLLOVER FROM IRA.—A taxpayer shall not be allowed to make a qualified rollover contribution to a Roth IRA from an individual retirement plan other than a Roth IRA during any taxable year if—

(i) the taxpayer's adjusted gross income for such taxable year exceeds $100,000, or

(ii) the taxpayer is a married individual filing a separate return.

(C) DEFINITIONS.—For purposes of this paragraph—

(i) adjusted gross income shall be determined in the same manner as under section 219(g)(3), except that any amount included in gross income under subsection (d)(3) shall not be taken into account and the deduction under section 219 shall be taken into account, and

(ii) the applicable dollar amount is—

(I) in the case of a taxpayer filing a joint return, $150,000,

(II) in the case of any other taxpayer (other than a married individual filing a separate return), $95,000, and

(III) in the case of a married individual filing a separate return, zero.

(D) MARITAL STATUS.—Section 219(g)(4) shall apply for purposes of this paragraph.

(4) CONTRIBUTIONS PERMITTED AFTER AGE 70½.—Contributions to a Roth IRA may be made even after the individual for whom the account is maintained has attained age 70½.

(5) MANDATORY DISTRIBUTION RULES NOT TO APPLY BEFORE DEATH.—Notwithstanding subsections (a)(6) and (b)(3) of section 408 (relating to required distributions), the following provisions shall not apply to any Roth IRA:

(A) Section 401(a)(9)(A).

(B) The incidental death benefit requirements of section 401(a).

(6) ROLLOVER CONTRIBUTIONS.—

(A) IN GENERAL.—No rollover contribution may be made to a Roth IRA unless it is a qualified rollover contribution.

(B) COORDINATION WITH LIMIT.—A qualified rollover contribution shall not be taken into account for purposes of paragraph (2).

(7) TIME WHEN CONTRIBUTIONS MADE.—For purposes of this section, the rule of section 219(f)(3) shall apply.

(d) DISTRIBUTION RULES.—For purposes of this title—

(1) GENERAL RULES.—

(A) EXCLUSIONS FROM GROSS INCOME.—Any qualified distribution from a Roth IRA shall not be includible in gross income.

(B) NONQUALIFIED DISTRIBUTIONS.—In applying section 72 to any distribution from a Roth IRA which is not a qualified distribution, such distribution shall be treated as made from contributions to the Roth IRA to the extent that such distribution, when added to all previous distributions from the Roth IRA, does not exceed the aggregate amount of contributions to the Roth IRA.

(2) QUALIFIED DISTRIBUTION.—For purposes of this subsection—

(A) IN GENERAL.—The term "qualified distribution" means any payment or distribution—

(i) made on or after the date on which the individual attains age 59½,

(ii) made to a beneficiary (or to the estate of the individual) on or after the death of the individual,

(iii) attributable to the individual's being disabled (within the meaning of section 72(m)(7)), or

(iv) which is a qualified special purpose distribution.

(B) CERTAIN DISTRIBUTIONS WITHIN 5 YEARS.—A payment or distribution shall not be treated as a qualified distribution under subparagraph (A) if—

(i) it is made within the 5-taxable year period beginning with the 1st taxable year for which the individual made a contribution to a Roth IRA (or such individual's spouse made a contribution to a Roth IRA) established for such individual, or

(ii) in the case of a payment or distribution properly allocable (as determined in the manner prescribed by the Secretary) to a qualified rollover contribution from an individual retirement plan other than a Roth IRA (or income allocable thereto), it is made within the 5-taxable year period beginning with the taxable year in which the rollover contribution was made.

(3) ROLLOVERS FROM AN IRA OTHER THAN A ROTH IRA.—

(A) IN GENERAL.—Notwithstanding section 408(d)(3), in the case of any distribution to which this paragraph applies—

(i) there shall be included in gross income any amount which would be includible were it not part of a qualified rollover contribution,

(ii) section 72(t) shall not apply, and

(iii) in the case of a distribution before January 1, 1999, any amount required to be included in gross income by reason of this paragraph shall be so included ratably over the 4-taxable year period beginning with the taxable year in which the payment or distribution is made.

(B) DISTRIBUTIONS TO WHICH PARAGRAPH APPLIES.—This paragraph shall apply to a distribution from an individual retirement plan (other than a Roth IRA) maintained for the benefit of an individual which is contributed to a Roth IRA maintained for the benefit of such individual in a qualified rollover contribution.

(C) CONVERSIONS.—The conversion of an individual retirement plan (other than a Roth IRA) to a Roth IRA shall be treated for purposes of this paragraph as a distribution to which this paragraph applies.

(D) CONVERSION OF EXCESS CONTRIBUTIONS.—If, no later than the due date for filing the return of tax for any taxable year (without regard to extensions), an individual transfers, from an individual retirement plan (other than a Roth IRA), contributions for such taxable year (and any earnings allocable thereto) to a Roth IRA, no such amount shall be includible in gross income to the extent no deduction was allowed with respect to such amount.

(E) ADDITIONAL REPORTING REQUIREMENTS.—Trustees of Roth IRAs, trustees of individual retirement plans, or both, whichever is appropriate, shall include such additional information in reports required under section 408(i) as the Secretary may require to ensure that amounts required to be included in gross income under subparagraph (A) are so included.

(4) COORDINATION WITH INDIVIDUAL RETIREMENT ACCOUNTS.—Section 408(d)(2) shall be applied separately with respect to Roth IRAs and other individual retirement plans.

(5) QUALIFIED SPECIAL PURPOSE DISTRIBUTION.—For purposes of this section, the term "qualified special purpose distribution" means any distribution to which subparagraph (F) of section 72(t)(2) applies.

(e) QUALIFIED ROLLOVER CONTRIBUTION.—For purposes of this section, the term "qualified rollover contribution" means a rollover contribution to a Roth IRA from another such account, or from an individual retirement plan, but only if such rollover contribution meets the requirements of section 408(d)(3). For purposes of section 408(d)(3)(B), there shall be disregarded any qualified rollover contribution from an individual retirement plan (other than a Roth IRA) to a Roth IRA.

[CCH Explanation at ¶ 166. Committee Reports at ¶ 10,260.]

Amendment Notes

Act Sec. 302(a) amended subpart A of part I of subchapter D of chapter 1 by inserting after Code Sec. 408 a new Code Sec. 408A to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5143] CODE SEC. 409. QUALIFICATIONS FOR TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLANS.

* * *

(h) RIGHT TO DEMAND EMPLOYER SECURITIES; PUT OPTION.—

* * *

(2) PLAN MAY DISTRIBUTE CASH IN CERTAIN CASES.—

(A) IN GENERAL.—A plan which otherwise meets the requirements of this subsection or of section 4975(e)(7) shall not be considered to have failed to meet the requirements of section 401(a) merely because under the plan the benefits may be distributed in cash or in the form of employer securities.

(B) EXCEPTION FOR CERTAIN PLANS RESTRICTED FROM DISTRIBUTING SECURITIES.—

(i) IN GENERAL.—A plan to which this subparagraph applies shall not be treated as failing to meet the requirements of this subsection or section 401(a) merely because it does not permit a participant to exercise the right described in paragraph (1)(A) if such plan provides that the participant entitled to a distribution has a right to receive the distribution in cash, except that such plan may distribute employer securities subject to a requirement that such securities may be resold to the employer under terms which meet the requirements of paragraph (1)(B).

(ii) APPLICABLE PLANS.—This subparagraph shall apply to a plan which otherwise meets the requirements of this subsection or section 4975(e)(7) and which is established and maintained by—

(I) an employer whose charter or bylaws restrict the ownership of substantially all outstanding employer securities to employees or to a trust described in section 401(a), or

(II) an S corporation.

* * *

[CCH Explanation at ¶ 752. Committee Reports at ¶ 13,265.]

Amendment Notes

Act Sec. 1506(a)(1) amended Code Sec. 409(h)(2) by adding at the end a new subparagraph (B) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

Act Sec. 1506(a)(2)(A)-(B) amended Code Sec. 409(h)(2), as in effect before the amendment made by Act Sec. 1506(a)(1), by striking "A plan which" in the first sentence and inserting "(A) IN GENERAL.—A plan which", and by striking the last sentence. Prior to amendment, the last sentence of Code Sec. 409(h)(2) read as follows:

In the case of an employer whose charter or bylaws restrict the ownership of substantially all outstanding employer securities to employees or to a trust described in section 401(a), a plan which otherwise meets the requirements of this subsection or section 4975(e)(7) shall not be considered to have failed to meet the requirements of this subsection or of section 401(a) merely because it does not permit a participant to exercise the right described in paragraph (1)(A) if such plan provides that participants entitled to a distribution from the plan shall have a right to receive such distribution in cash except that such plan may distribute employer securities subject to a requirement that such securities may be resold to the employer under terms which meet the requirements of paragraph (1)(B).

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5145] CODE SEC. 410. MINIMUM PARTICIPATION STANDARDS

* * *

(c) APPLICATION OF PARTICIPATION STANDARDS TO CERTAIN PLANS.—

* * *

(2) A plan described in paragraph (1) shall be treated as meeting the requirements of this section for purposes of section 401(a), except that in the case of a plan described in subparagraph (B), (C), or (D) of paragraph (1), this paragraph shall apply only if such plan meets the requirements of section 401(a)(3) (as in effect on September 1, 1974).

* * *

[CCH Explanation at ¶ 758. Committee Reports at ¶ 13,255.]

Amendment Notes

Act Sec. 1505(a)(3) amended Code Sec. 410(c)(2) to read as above. Prior to amendment, Code Sec. 410(c)(2) read as follows:

(2) A plan described in paragraph (1) shall be treated as meeting the requirements of this section, for purposes of section 401(a), if such plan meets the requirements of section 401(a)(3) as in effect on September 1, 1974.

The above amendments generally applies to tax years beginning on or after the date of enactment of this Act. For a special rule, see Act Sec. 1505(d)(2), below.

Act Sec. 1505(d)(2) provides:

(2) TREATMENT FOR YEARS BEGINNING BEFORE DATE OF ENACTMENT.—A governmental plan (within the meaning of section 414(d) of the Internal Revenue Code of 1986) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof) shall be treated as satisfying the requirements of sections 401(a)(3), 401(a)(4), 401(a)(26), 401(k), 401(m), 403(b)(1)(D) and (b)(12), and 410 of such Code for all taxable years beginning before the date of enactment of this Act.

[¶ 5147] CODE SEC. 411. MINIMUM VESTING STANDARDS.

(a) GENERAL RULE.—* * *

* * *

(7) ACCRUED BENEFIT.—

* * *

(B) EFFECT OF CERTAIN DISTRIBUTIONS.—Notwithstanding paragraph (4), for purposes of determining the employee's accrued benefit under the plan, the plan may disregard service performed by the employee with respect to which he has received—

(i) a distribution of the present value of his entire nonforfeitable benefit if such distribution was in an amount (not more than *the dollar limit under section 411 (a)(11)(A)*) permitted under regulations prescribed by the Secretary, or

(ii) a distribution of the present value of his nonforfeitable benefit attributable to such service which he elected to receive.

Clause (i) of this subparagraph shall apply only if such distribution was made on termination of the employee's participation in the plan. Clause (ii) of this subparagraph shall apply only if such distribution was made on termination of the employee's participation in the plan or under such other circumstances as may be provided under regulations prescribed by the Secretary.

* * *

(11) RESTRICTIONS ON CERTAIN MANDATORY DISTRIBUTIONS.—

(A) IN GENERAL.—If the present value of any nonforfeitable accrued benefit exceeds *$5,000* a plan meets the requirements of this paragraph only if such plan provides that such benefit may not be immediately distributed without the consent of the participant.

* * *

[CCH Explanation at ¶ 706. Committee Reports at ¶ 11,445.]

Amendment Notes

Act Sec. 1071(a)(1) amended Code Sec. 411(a)(11)(A) by striking "$3,500" and inserting "$5,000".

Act Sec. 1071(a)(2)(A) amended Code Sec. 411(a)(7)(B) by striking "$3,500" each place it appears (other than the heading) and inserting "the dollar limit under section 411(a)(11)(A)".

The above amendments apply to plan years beginning after the date of the enactment of this Act.

[¶ 5149] CODE SEC. 412. MINIMUM FUNDING STANDARDS.

* * *

(b) FUNDING STANDARD ACCOUNT.—

* * *

(2) CHARGES TO ACCOUNT.—For a plan year, the funding standard account shall be charged with the sum of—

(A) the normal cost of the plan for the plan year,

(B) the amounts necessary to amortize in equal annual installments (until fully amortized)—

(i) in the case of a plan in existence on January 1, 1974, the unfunded past service liability under the plan on the first day of the first plan year to which this section applies, over a period of 40 plan years,

(ii) in the case of a plan which comes into existence after January 1, 1974, the unfunded past service liability under the plan on the first day of the first plan year to which this section applies, over a period of 30 plan years,

(iii) separately, with respect to each plan year, the net increase (if any) in unfunded past service liability under the plan arising from plan amendments adopted in such year, over a period of 30 plan years,

(iv) separately, with respect to each plan year, the net experience loss (if any) under the plan, over a period of 5 plan years (15 plan years in the case of a multiemployer plan), and

(v) separately, with respect to each plan year, the net loss (if any) resulting from changes in actuarial assumptions used under the plan, over a period of 10 plan years (30 plan years in the case of a multiemployer plan),

[Caution: Code Sec. 412(b)(2)(C)-(E), below, as amended by Act Sec. 1521(c)(1) of the Taxpayer Relief Act of 1997, generally applies to plan years beginning after December 31, 1998.—CCH.]

(C) the amount necessary to amortize each waived funding deficiency (within the meaning of subsection (d)(3)) for each prior plan year in equal annual installments (until fully amortized) over a period of 5 plan years (15 plan years in the case of a multiemployer plan),

(D) the amount necessary to amortize in equal annual installments (until fully amortized) over a period of 5 plan years any amount credited to the funding standard account under paragraph (3)(D), *and*

(E) the amount necessary to amortize in equal annual installments (until fully amortized) over a period of 20 years the contributions which would be required to be made under the plan but for the provisions of subsection (c)(7)(A)(i)(I).

For additional requirements in the case of plans other than multiemployer plans, see subsection (l).

* * *

Amendment Notes

Act Sec. 1521(c)(1) amended Code Sec. 412(b)(2) by striking "and" at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting ", and", and by inserting after subparagraph (D) a new subparagraph (E) to read as above.

The above amendments generally applies to plan years beginning after December 31, 1998. For a special rule, see Act Sec. 1521(d)(2)(A)-(B) below.

Act Sec. 1521(d)(2)(A)-(B) provides:

(2) SPECIAL RULE FOR UNAMORTIZED BALANCES UNDER EXISTING LAW.—The unamortized balance (as of the close of the plan year prededing the plan's first year beginning in 1999) of any amortization base established under section 412(c)(7)(D)(iii) of such Code and section 302(c)(7)(D)(iii) of such Act (as repealed by subsection (c)(3)) for any plan year beginning before 1999 shall be amortized in equal annual installments (until fully amortized) over a period of years equal to the excess of—

(A) 20 years, over

(B) the number of years since the amortization base was established.

(c) SPECIAL RULES.—

* * *

[Caution: Code Sec. 412(c)(7), below, as amended by Act Sec. 1521 of the Taxpayer Relief Act of 1997, generally applies to plan years beginning after December 31, 1998.—CCH.]

(7) FULL-FUNDING LIMITATION.—

(A) IN GENERAL.—For purposes of paragraph (6), the term "full-funding limitation" means the excess (if any) of—

(i) the lesser of (I) *the applicable percentage* of current liability (including the expected increase in current liability due to benefits accruing during the plan year), or (II) the accrued liability (including normal cost) under the plan (determined under the entry age normal funding method if such accrued liability cannot be directly calculated under the funding method used for the plan), over

* * *

(D) REGULATORY AUTHORITY.—The Secretary may by regulations provide—

(i) for adjustments to the percentage contained in subparagraph (A)(i) to take into account the respective ages or lengths of service of the participants, *and*

(ii) alternative methods based on factors other than current liability for the determination of the amount taken into account under subparagraph (A)(i).

* * *

(F) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A)(i)(I), the applicable percentage shall be determined in accordance with the following table:

In the case of any plan year beginning in—	*The applicable percentage is—*
1999 or 2000	*155*
2001 or 2002	*160*
2003 or 2004	*165*
2005 and succeeding years	*170*

* * *

Amendment Notes

Act Sec. 1521(a)(A)[1]-(B)[2] amended Code Sec. 412(c)(7) by striking "150 percent" in subparagraph (A)(i)(I) and inserting "the applicable percentage", and by adding at the end a new subparagraph (F) to read as above.

Act Sec. 1521(c)(3)(A) amended Code Sec. 412(c)(7)(D) by adding "and" at the end of clause (i), by striking ", and" at the end of clause (ii) and inserting a period, and by striking clause (iii). Prior to being stricken, Code Sec. 412(c)(7)(D)(iii) read as follows:

(iii) for the treatment under this section of contributions which would be required to be made under the plan but for the provisions of subparagraph (A)(i)(I).

The above amendments generally apply to plan years beginning after December 31, 1998. For a special rule, see Act Sec. 1521(d)(2)(A)-(B).

Act Sec. 1521(d)(2)(A)-(B) provides:

(2) SPECIAL RULE FOR UNAMORTIZED BALANCES UNDER EXISTING LAW.—The unamortized balance (as of the close of the plan year preceding the plan's first year beginning in 1999) of any amortization base established under section 412(c)(7)(D)(iii) of such Code and section 302(c)(7)(D)(iii) of such Act (as repealed by subsection (c)(3)) for any plan year beginning before 1999 shall be amortized in equal annual installments (until fully amortized) over a period of years equal to the excess of—

(A) 20 years, over

(B) the number of years since the amortization base was established.

(m) QUARTERLY CONTRIBUTIONS REQUIRED.—

* * *

(5) LIQUIDITY REQUIREMENT.—

* * *

(E) DEFINITIONS.—For purposes of this paragraph:

* * *

(ii) BASE AMOUNT.—

* * *

(II) SPECIAL RULE.—If the amount determined under *subclause (I)* exceeds an amount equal to 2 times the sum of the adjusted disbursements from the plan for the 36 months ending on the last day of the quarter and an enrolled actuary certifies to the satisfaction of the Secretary that such excess is the result of nonrecurring circumstances, the base amount with respect to such quarter shall be determined without regard to amounts related to those nonrecurring circumstances.

* * *

[CCH Explanation at ¶ 717 and 719. Committee Reports at ¶ 13,335 and 13,340.]

Amendment Notes

Act Sec. 1604(b)(2)(A) amended Code Sec. 412(m)(5)(E)(ii)(II) by striking "clause (i)" and inserting "subclause (I)".

The above amendment is effective as if included in the section of the Uruguay Round Agreements Act (P.L. 103-465) to which it relates [effective for plan years beginning after December 31, 1994.—CCH.].

[¶ 5151] CODE SEC. 414. DEFINITIONS AND SPECIAL RULES.

* * *

(e) CHURCH PLAN.—

* * *

(5) SPECIAL RULES FOR CHAPLAINS AND SELF-EMPLOYED MINISTERS.—

(A) CERTAIN MINISTERS MAY PARTICIPATE.—For purposes of this part—

(i) IN GENERAL.—A duly ordained, commissioned, or licensed minister of a church is described in paragraph (3)(B) if, in connection with the exercise of their ministry, the minister—

(I) is a self-employed individual (within the meaning of section 401(c)(1)(B), or

(II) is employed by an organization other than an organization which is described in section 501(c)(3) and with respect to which the minister shares common religious bonds.

(ii) TREATMENT AS EMPLOYER AND EMPLOYEE.—For purposes of sections 403(b)(1)(A) and 404(a)(10), a minister described in clause (i)(I) shall be treated as employed by the minister's own employer which is an organization described in section 501(c)(3) and exempt from tax under section 501(a).

* * *

(C) EFFECT ON NON-DENOMINATIONAL PLANS.—If a duly ordained, commissioned, or licensed minister of a church in the exercise of his or her ministry participates in a church plan (within the meaning of this section) and in the exercise of such ministry is employed by an employer *not otherwise participating* in such church plan, then such employer may exclude such minister from being treated as an employee of such employer for purposes of applying sections 401(a)(3), 401(a)(4), and 401(a)(5), as in effect on September 1, 1974, and sections401(a)(4),401(a)(5), 401(a)(26), 401(k)(3), 401(m), 403(b)(1)(D) (including section 403(b)(12)), and 410 to any stock bonus, pension, profit-sharing, or annuity plan (including an annuity described in section 403(b) or a retirement income account described in section 403(b)(9)). The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purpose of, and prevent the abuse of, this subparagraph.

* * *

(E) EXCLUSION.—In the case of a contribution to a church plan made on behalf of a minister described in subparagraph (A)(i)(II), such contribution shall not be included in the gross income of the minister to the extent that such contribution would not be so included if the minister was an employee of a church.

* * *

Amendment Notes

Act Sec. 1522(a)(1)-(2) amended Code Sec. 414(e)(5) by striking "not eligible to participate" in subparagraph (C) and inserting "not otherwise participating", and by adding at the end a new subparagraph (E) to read as above.

The above amendment applies to years beginning after December 31, 1997.

Act Sec. 1601(d)(6)(A) amended Code Sec. 414(e)(5)(A) to read as above. Prior to amendment, Code Sec. 414(e)(5)(A) read as follows:

(A) CERTAIN MINISTERS MAY PARTICIPATE.—For purposes of this part—

(i) IN GENERAL.—An employee of a church or a convention or association of churches shall include a duly ordained, commissioned, or licensed minister of a church who, in connection with the exercise of his or her ministry—

(I) is a self-employed individual (within the meaning of section 401(c)(1)(B)), or

(II) is employed by an organization other than an organization described in section 501(c)(3).

(ii) TREATMENT AS EMPLOYER AND EMPLOYEE.—

(I) SELF-EMPLOYED.—A minister described in clause (i)(I) shall be treated as his or her own employer which is an organization described in section 501(c)(3) and which is exempt from tax under section 501(a).

(II) OTHERS.—A minister described in clause (i)(II) shall be treated as employed by an organization described in section 501(c)(3) and exempt from tax under section 501(a).

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for years beginning after December 31, 1996.—CCH.].

(n) EMPLOYEE LEASING.—

* * *

(3) REQUIREMENTS.—For purposes of this subsection, the requirements listed in this paragraph are—

(A) paragraphs (3), (4), (7), (16), (17), and (26) of section 401(a),

(B) sections 408(k), 408(p), 410, 411, 415, and 416, and

(C) sections 79, 106, 117(d), 120, 125, 127, 129, 132, *137,* 274(j), 505, and 4980B.

* * *

Amendment Notes

Act Sec. 1601(h)(2)(D)(i) amended Code Sec. 414(n)(3)(C) by inserting "137," after "132,".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

(q) HIGHLY COMPENSATED EMPLOYEE.—

* * *

(9) CERTAIN EMPLOYEES NOT CONSIDERED HIGHLY COMPENSATED AND EXCLUDED EMPLOYEES UNDER PRE-ERISA RULES FOR CHURCH PLANS.—In the case of a church plan (as defined in subsection (e)), no employee shall be considered an officer, a person whose principal duties consist of supervising the work of other employees, or a highly compensated employee for any year unless such employee is a highly compensated employee under paragraph (1) for such year.

* * *

Amendment Notes

Act Sec. 1601(d)(7) amended Code Sec. 414(q)(7) (as added by Act Sec. 1462 of the Small Business Job Protection Act of 1996) by redesignating it as paragraph (9).

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for years beginning after December 31, 1996.—CCH.].

(t) APPLICATION OF CONTROLLED GROUP RULES TO CERTAIN EMPLOYEE BENEFITS.—

* * *

(2) APPLICABLE SECTION.—For purposes of this subsection, the term "applicable section" means section 79, 106, 117(d), 120, 125, 127, 129, 132, *137,* 274(j), 505, or 4980B.

* * *

[CCH Explanation at ¶ 766 and 768. Committee Reports at ¶ 13,345, 13,347 and 13,640.]

Amendment Notes

Act Sec. 1601(h)(2)(D)(ii) amended Code Sec. 414(t)(2) by inserting "137," after "132,".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

[¶ 5153] CODE SEC. 415. LIMITATIONS ON BENEFITS AND CONTRIBUTION UNDER QUALIFIED PLANS.

* * *

(b) LIMITATION FOR DEFINED BENEFIT PLANS.—

* * *

(2) ANNUAL BENEFIT.—

* * *

(G) SPECIAL LIMITATION FOR QUALIFIED POLICE OR FIREFIGHTERS.—In the case of a qualified *participant, subparagraph (C) of this paragraph shall not apply.*

* * *

Amendment Notes

Act Sec. 1527(a) amended Code Sec. 415(b)(2)(G) by striking "participant—" and all that follows and inserting "participant, subparagraph (C) of this paragraph shall not apply." Prior to amendment, Code Sec. 415(b)(2)(G) read as follows:

(G) SPECIAL LIMITATION FOR QUALIFIED POLICE OR FIREFIGHTERS.—In the case of a qualified participant—

(i) subparagraph (C) shall not reduce the limitation of paragraph (1)(A) to an amount less than $50,000, and

(ii) the rules of subparagraph (F) shall apply.

The Secretary shall adjust the $50,000 amount in clause (i) at the same time and in the same manner as under section 415(d).

The above amendment applies to years beginning after December 31, 1996.

(c) LIMITATION FOR DEFINED CONTRIBUTION PLANS.—

* * *

(6) SPECIAL RULE FOR EMPLOYEE STOCK OWNERSHIP PLANS.—If no more than one-third of the employer contributions to an employee stock ownership plan (as described in section 4975(e)(7)) for a year which are deductible under paragraph (9) of section 404(a) are allocated to highly compensated employees (within the meaning of section 414(q)), the limitations imposed by this section shall not apply to—

(A) forfeitures of employer securities (within the meaning of section 409) under such an employee stock ownership plan if such securities were acquired with the proceeds of a loan (as described in section 404(a)(9)(A)), or

(B) employer contributions to such an employee stock ownership plan which are deductible under section 404(a)(9)(B) and charged against the participant's account.

The amount of any qualified gratuitous transfer (as defined in section 664(g)(1)) allocated to a participant for any limitation year shall not exceed the limitations imposed by this section, but such

amount shall not be taken into account in determining whether any other amount exceeds the limitations imposed by this section.

* * *

Amendment Notes

Act Sec. 1530(c)(3) amended Code Sec. 415(c)(6) by adding at the end thereof a new sentence to read as above.

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

[*Caution: Code Sec. 415(e), below, was repealed by P.L. 104-188, applicable to limitation years beginning after December 31, 1999.*]

(e) LIMITATION IN CASE OF DEFINED BENEFIT PLAN AND DEFINED CONTRIBUTION PLAN FOR SAME EMPLOYEE.—

* * *

(6) SPECIAL RULE FOR QUALIFIED GRATUITOUS TRANSFERS.—Any qualified gratuitous transfer of qualified employer securities (as defined by section 664(g)) shall not be taken into account in calculating, and shall not be subject to, the limitations provided in this subsection.

(7) SPECIAL TRANSITION RULE FOR DEFINED CONTRIBUTION FRACTION FOR YEARS ENDING AFTER DECEMBER 31, 1982.—

(A) IN GENERAL.—At the election of the plan administrator, in applying paragraph (3) with respect to any year ending after December 31, 1982, the amount taken into account under paragraph (3)(B) with respect to each participant for all years ending before January 1, 1983, shall be an amount equal to the product of—

(i) the amount determined under paragraph (3)(B) (as in effect for the year ending in 1982) for the year ending in 1982, multiplied by

(ii) the transition fraction.

(B) TRANSITION FRACTION.—The term "transition fraction" means a fraction—

(i) the numerator of which is the lesser of—

(I) $51,875, or

(II) 1.4, multiplied by 25 percent of the compensation of the participant for the year ending in 1981, and

(ii) the denominator of which is the lesser of—

(I) $41,500, or

(II) 25 percent of the compensation of the participant for the year ending in 1981.

(C) PLAN MUST HAVE BEEN IN EXISTENCE ON OR BEFORE JULY 1, 1982.—This paragraph shall apply only to plans which were in existence on or before July 1, 1982.

* * *

Amendment Notes

Act Sec. 1504(b) provides:

(b) REPEAL OF RULES IN SECTION 415(e).—The Secretary of the Treasury shall modify the regulations regarding the exclusion allowance under section 403(b)(2) of the Internal Revenue Code of 1986 to reflect the amendment made by section 1452(a) of the Small Business Job Protection Act of 1996. Such modification shall take effect for years beginning after December 31, 1999.

Act Sec. 1530(c)(4)(A)-(B) amended Code Sec. 415(e) by redesignating paragraph (6) as paragraph (7), and by inserting after paragraph (5) a new paragraph (6) to read as above.

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

(k) SPECIAL RULES.—

* * *

(3) REPAYMENTS OF CASHOUTS UNDER GOVERNMENTAL PLANS.—In the case of any repayment of contributions (including interest thereon) to the governmental plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan or under another governmental plan maintained by a State or local government employer within the same State, any such repayment shall not be taken into account for purposes of this section.

* * *

Amendment Notes

Act Sec. 1526(b) amended Code Sec. 415(k) by adding at the end a new paragraph (3) to read as above.

The above amendment generally applies to permissive service credit contributions made in years begin-

ning after December 31, 1997. For a transition rule, see Act Sec. 1526(c)(2)(A)-(B), below.

Act Sec. 1526(c)(2)(A)-(B) provides:

(2) TRANSITION RULE.—

(A) IN GENERAL.—In the case of an eligible participant in a governmental plan (within the meaning of section 414(d) of the Internal Revenue Code of 1986), the limitations of section 415(c)(1) of such Code shall not be applied to reduce the amount of permissive service credit which may be purchased to an amount less than the amount which was allowed to be purchased under the terms of the plan as in effect on the date of the enactment of this Act.

(B) ELIGIBLE PARTICIPANT.—For purposes of subparagraph (A), an eligible participant is an individual who first became a participant in the plan before the first plan year beginning after the last day of the calendar year in which the next regular session (following the date of the enactment of this Act) of the governing body with authority to amend the plan ends.

(n) SPECIAL RULES RELATING TO PURCHASE OF PERMISSIVE SERVICE CREDIT.—

(1) IN GENERAL.—If an employee makes 1 or more contributions to a defined benefit governmental plan (within the meaning of section 414(d)) to purchase permissive service credit under such plan, then the requirements of this section shall be treated as met only if—

(A) the requirements of subsection (b) are met, determined by treating the accrued benefit derived from all such contributions as an annual benefit for purposes of subsection (b), or

(B) the requirements of subsection (c) are met, determined by treating all such contributions as annual additions for purposes of subsection (c).

(2) APPLICATION OF LIMIT.—For purposes of—

(A) applying paragraph (1)(A), the plan shall not fail to meet the reduced limit under subsection (b)(2)(C) solely by reason of this subsection, and

(B) applying paragraph (1)(B), the plan shall not fail to meet the percentage limitation under subsection (c)(1)(B) solely by reason of this subsection.

(3) PERMISSIVE SERVICE CREDIT.—For purposes of this subsection—

(A) IN GENERAL.—The term "permissive service credit" means service credit—

(i) recognized by the governmental plan for purposes of calculating a participant's benefit under the plan,

(ii) which such participant has not received under such governmental plan, and

(iii) which such participant may receive only by making a voluntary additional contribution, in an amount determined under such governmental plan, which does not exceed the amount necessary to fund the benefit attributable to such service credit.

(B) LIMITATION ON NONQUALIFIED SERVICE CREDIT.—A plan shall fail to meet the requirements of this section if—

(i) more than 5 years of permissive service credit attributable to nonqualified service are taken into account for purposes of this subsection, or

(ii) any permissive service credit attributable to nonqualified service is taken into account under this subsection before the employee has at least 5 years of participation under the plan.

(C) NONQUALIFIED SERVICE.—For purposes of subparagraph (B), the term "nonqualified service" means service for which permissive service credit is allowed other than—

(i) service (including parental, medical, sabbatical, and similar leave) as an employee of the Government of the United States, any State or political subdivision thereof, or any agency or instrumentality of any of the foregoing (other than military service or service for credit which was obtained as a result of a repayment described in subsection (k)(3)),

(ii) service (including parental, medical, sabbatical, and similar leave) as an employee (other than as an employee described in clause (i)) of an educational organization described in section 170(b)(1)(A)(ii) which is a public, private, or sectarian school which provides elementary or secondary education (through grade 12), as determined under State law,

(iii) service as an employee of an association of employees who are described in clause (i), or

(iv) military service (other than qualified military service under section 414(u)) recognized by such governmental plan.

In the case of service described in clauses (i), (ii), or (iii), such service will be nonqualified service if recognition of such service would cause a participant to receive a retirement benefit for the same service under more than one plan.

* * *

[CCH Explanation at ¶ 284, 723, 764 and 776. Committee Reports at ¶ 13,245, 13,385, 13,395 and 13,435.]

Amendment Notes

Act Sec. 1526(a) amended Code Sec. 415 by adding at the end a new subsection (n) to read as above.

The above amendment generally applies to permissive service credit contributions made in years beginning after December 31, 1997. For a transition rule, see Act Sec. 1526(c)(2)(A)-(B), below.

Act Sec. 1526(c)(2)(A)-(B) provides:

(2) TRANSITION RULE.—

(A) IN GENERAL.—In the case of an eligible participant in a governmental plan (within the meaning of section 414(d) of the Internal Revenue Code of 1986), the limitations of section 415(c)(1) of such Code shall not be applied to reduce the amount of permissive service credit which may be purchased to an amount less than the amount which was allowed to be purchased under the terms of the plan as in effect on the date of the enactment of this Act.

(B) ELIGIBLE PARTICIPANT.—For purposes of subparagraph (A), an eligible participant is an individual who first became a participant in the plan before the first plan year beginning after the last day of the calendar year in which the next regular session (following the date of the enactment of this Act) of the governing body with authority to amend the plan ends.

[¶ 5155] CODE SEC. 417. DEFINITIONS AND SPECIAL RULES FOR PURPOSES OF MINIMUM SURVIVOR ANNUITY REQUIREMENTS.

* * *

(e) RESTRICTIONS ON CASH-OUTS.—

(1) PLAN MAY REQUIRE DISTRIBUTION IF PRESENT VALUE NOT IN EXCESS OF *DOLLAR LIMIT*.—A plan may provide that the present value of a qualified joint and survivor annuity or a qualified preretirement survivor annuity will be immediately distributed if such value does not exceed *the dollar limit under section 411(a)(11)(A)*. No distribution may be made under the preceding sentence after the annuity starting date unless the participant and the spouse of the participant (or where the participant has died, the surviving spouse) consents in writing to such distribution.

(2) PLAN MAY DISTRIBUTE BENEFIT IN EXCESS OF *DOLLAR LIMIT* ONLY WITH CONSENT.—If—

(A) the present value of the qualified joint and survivor annuity or the qualified preretirement survivor annuity exceeds *the dollar limit under section 411(a)(11)(A)*, and

(B) the participant and the spouse of the participant (or where the participant has died, the surviving spouse) consent in writing to the distribution,

the plan may immediately distribute the present value of such annuity.

* * *

[CCH Explanation at ¶ 706. Committee Reports at ¶ 11,445.]

Amendment Notes

Act Sec. 1071(a)(2)(A) amended Code Sec. 417(e)(1) and (2) by striking "$3,500" each place it appears (other than the headings) and inserting "the dollar limit under section 411(a)(11)(A)".

Act Sec. 1071(a)(2)(B) amended Code Sec. 417(e)(1) and (2) by striking "$3,500" in the headings and inserting "DOLLAR LIMIT".

The above amendments apply to plan years beginning after the date of the enactment of this Act.

[¶ 5157] CODE SEC. 447. METHOD OF ACCOUNTING FOR CORPORATIONS ENGAGED IN FARMING.

* * *

(i) SUSPENSE ACCOUNT FOR FAMILY CORPORATIONS.—

* * *

(3) INCLUSION WHERE CORPORATION CEASES TO BE A FAMILY CORPORATION.—

* * *

(4) SUBCHAPTER C TRANSACTIONS.—The application of this subsection with respect to a taxpayer which is a party to any transaction with respect to which there is nonrecognition of gain or loss to any party by reason of subchapter C shall be determined under regulations prescribed by the Secretary.

(5) TERMINATION.—

(A) IN GENERAL.—No suspense account may be established under this subsection by any corporation required by this section to change its method of accounting for any taxable year ending after June 8, 1997.

(B) PHASEOUT OF EXISTING SUSPENSE ACCOUNTS.—

(i) IN GENERAL.—Each suspense account under this subsection shall be reduced (but not below zero) for each taxable year beginning after June 8, 1997, by an amount equal to the lesser of—

(I) the applicable portion of such account, or

(II) 50 percent of the taxable income of the corporation for the taxable year, or, if the corporation has no taxable income for such year, the amount of any net operating loss (as defined in section 172(c)) for such taxable year.

For purposes of the preceding sentence, the amount of taxable income and net operating loss shall be determined without regard to this paragraph.

(ii) COORDINATION WITH OTHER REDUCTIONS.—The amount of the applicable portion for any taxable year shall be reduced (but not below zero) by the amount of any reduction required for such taxable year under any other provision of this subsection.

(iv) INCLUSION IN INCOME.—Any reduction in a suspense account under this paragraph shall be included in gross income for the taxable year of the reduction.

(C) APPLICABLE PORTION.—For purposes of subparagraph (B), the term "applicable portion" means, for any taxable year, the amount which would ratably reduce the amount in the account (after taking into account prior reductions) to zero over the period consisting of such taxable year and the remaining taxable years in such first 20 taxable years.

(D) AMOUNTS AFTER 20TH YEAR.—Any amount in the account as of the close of the 20th year referred to in subparagraph (C) shall be treated as the applicable portion for each succeeding year thereafter to the extent not reduced under this paragraph for any prior taxable year after such 20th year.

* * *

[CCH Explanation at ¶ 365. Committee Reports at ¶ 11,515.]

Amendment Notes

Act Sec. 1081(a) amended Code Sec. 447(i) by striking paragraphs (3) and (4), by redesignating paragraphs (5) and (6) as paragraphs (3) and (4), respectively, and by adding at the end a new paragraph (5) to read as above. Prior to being stricken, Code Sec. 447(i)(3)-(4) read as follows

(3) REDUCTION IN ACCOUNT IF FARMING BUSINESS CONTRACTS.—If—

(A) the gross receipts of the corporation from the trade or business of farming for the year of the change or any subsequent taxable year, is less than

(B) such gross receipts for the taxpayer's last taxable year beginning before the year of the change (or for the most recent taxable year for which a reduction in the suspense account was made under this paragraph),

the amount in the suspense account (after taking into account prior reductions) shall be reduced by the percentage by which the amount described in subparagraph (A) is less than the amount described in subparagraph (B).

(4) INCOME INCLUSIONS.—Any reduction in the suspense account under paragraph (3) shall be included in gross income for the taxable year of the reduction.

The above amendment applies to tax years ending after June 8, 1997.

[¶ 5159] CODE SEC. 451. GENERAL RULE FOR TAXABLE YEAR OF INCLUSION.

* * *

(e) SPECIAL RULE FOR PROCEEDS FROM LIVESTOCK SOLD ON ACCOUNT OF DROUGHT, *FLOOD, OR OTHER WEATHER-RELATED CONDITIONS.*—

(1) IN GENERAL.—In the case of income derived from the sale or exchange of livestock in excess of the number the taxpayer would sell if he followed his usual business practices, a taxpayer reporting on the cash receipts and disbursements method of accounting may elect to include such income for the taxable year following the taxable year in which such sale or exchange occurs if he establishes that, under his usual business practices, the sale or exchange would not have occurred in the taxable year in which it occurred if it were not for *drought, flood, or other weather-related conditions, and that such conditions* had resulted in the area being designated as eligible for assistance by the Federal Government.

* * *

[CCH Explanation at ¶ 367. Committee Reports at ¶ 10,595.]

Amendment Notes

Act Sec. 913(a)(1)-(2) amended Code Sec. 451(e) by striking "drought conditions, and that these drought conditions" in paragraph (1) and inserting "drought, flood, or other

weather-related conditions, and that such conditions" and by inserting ", FLOOD, OR OTHER WEATHER-RELATED CONDITIONS" after "DROUGHT" in the heading.

The above amendment applies to sales and exchanges after December 31, 1996.

[¶ 5161] CODE SEC. 457. DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.

* * *

(e) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

* * *

(9) BENEFITS NOT TREATED AS MADE AVAILABLE BY REASON OF CERTAIN ELECTIONS, ETC.—

(A) TOTAL AMOUNT PAYABLE IS *DOLLAR LIMIT* OR LESS.—The total amount payable to a participant under the plan shall not be treated as made available merely because the participant may elect to receive such amount (or the plan may distribute such amount without the participant's consent) if—

(i) such amount does not exceed *the dollar limit under section 411(a)(11)(A)*, and

(ii) such amount may be distributed only if—

(I) no amount has been deferred under the plan with respect to such participant during the 2-year period ending on the date of the distribution, and

(II) there has been no prior distribution under the plan to such participant to which this subparagraph applied.

A plan shall not be treated as failing to meet the distribution requirements of subsection (d) by reason of a distribution to which this subparagraph applies.

* * *

[CCH Explanation at ¶ 706. Committee Reports at ¶ 11,445.]

Amendment Notes

Act Sec. 1071(a)(2)(A) amended Code Sec. 457(e)(9) by striking "$3,500" each place it appears (other than the headings) and inserting "the dollar limit under section 411(a)(11)(A)".

Act Sec. 1071(a)(2)(B) amended Code Sec. 457(e)(9)(A) by striking "$3,500" in the heading and inserting "DOLLAR LIMIT".

The above amendments apply to plan years beginning after the date of the enactment of this Act.

[¶ 5163] CODE SEC. 460. SPECIAL RULES FOR LONG-TERM CONTRACTS.

* * *

(b) PERCENTAGE OF COMPLETION METHOD.—

* * *

(2) LOOK-BACK METHOD.—The interest computed under the look-back method of this paragraph shall be determined by—

(A) first allocating income under the contract among taxable years before the year in which the contract is completed on the basis of the actual contract price and costs instead of the estimated contract price and costs,

(B) second, determining (solely for purposes of computing such interest) the overpayment or underpayment of tax for each taxable year referred to in subparagraph (A) which would result solely from the application of subparagraph (A), and

(C) then using *the adjusted overpayment rate (as defined in paragraph (7))*, compounded daily, on the overpayment or underpayment determined under subparagraph (B).

For purposes of the preceding sentence, any amount properly taken into account after completion of the contract shall be taken into account by discounting (using the Federal mid-term rate determined under section 1274(d) as of the time is so properly taken into account) such amount to its value as of the completion of the contract. The taxpayer may elect with respect to any contract to have the preceding sentence not apply to such contract.

* * *

(6) ELECTION TO HAVE LOOK-BACK METHOD NOT APPLY IN DE MINIMIS CASES.—

(A) Amounts taken into account after completion of contract.—Paragraph (1)(B) shall not apply with respect to any taxable year (beginning after the taxable year in which the contract is completed) if—

(i) the cumulative taxable income (or loss) under the contract as of the close of such taxable year, is within

(ii) 10 percent of the cumulative look-back taxable income (or loss) under the contract as of the close of the most recent taxable year to which paragraph (1)(B) applied (or would have applied but for subparagraph (B)).

(B) De minimis discrepancies.—Paragraph (1)(B) shall not apply in any case to which it would otherwise apply if—

(i) the cumulative taxable income (or loss) under the contract as of the close of each prior contract year, is within

(ii) 10 percent of the cumulative look-back income (or loss) under the contract as of the close of such prior contract year.

(C) Definitions.—For purposes of this paragraph—

(i) Contract year.—The term "contract year" means any taxable year for which income is taken into account under the contract.

(ii) Look-back income or loss.—The look-back income (or loss) is the amount which would be the taxable income (or loss) under the contract if the allocation method set forth in paragraph (2)(A) were used in determining taxable income.

(iii) Discounting not applicable.—The amounts taken into account after the completion of the contract shall be determined without regard to any discounting under the 2nd sentence of paragraph (2).

(D) Contracts to which paragraph applies.—This paragraph shall only apply if the taxpayer makes an election under this subparagraph. Unless revoked with the consent of the Secretary, such an election shall apply to all long-term contracts completed during the taxable year for which election is made or during any subsequent taxable year.

(7) Adjusted overpayment rate.—

(A) In general.—The adjusted overpayment rate for any interest accrual period is the overpayment rate in effect under section 6621 for the calendar quarter in which such interest accrual period begins.

(B) Interest accrual period.—For purposes of subparagraph (A), the term "interest accrual period" means the period—

(i) beginning on the day after the return due date for any taxable year of the taxpayer, and

(ii) ending on the return due date for the following taxable year.

For purposes of the preceding sentence, the term "return due date" means the date prescribed for filing the return of the tax imposed by this chapter (determined without regard to extensions).

* * *

[CCH Explanation at ¶ 338. Committee Reports at ¶ 12,165.]

Amendment Notes

Act Sec. 1211(a) amended Code Sec. 460(b) by adding at the end a new paragraph (6) to read as above.

The above amendment applies to contracts completed in tax years ending after the date of the enactment of this Act.

Act Sec. 1211(b)(1) amended Code Sec. 460(b)(2)(C) by striking "the overpayment rate established by section 6621" and inserting "the adjusted overpayment rate (as defined in paragraph (7))".

Act Sec. 1211(b)(2) amended Code Sec. 460(b) by adding at the end a new paragraph (7) to read as above.

The above amendments apply for purposes of Code Sec. 167(g) to property placed in service after September 13, 1995.

[¶ 5165] CODE SEC. 464. LIMITATIONS ON DEDUCTIONS FOR CERTAIN FARMING [EXPENSES].

* * *

(f) Subsections (a) and (b) to Apply to Certain Persons Prepaying 50 Percent or More of Certain Farming Expenses.—

* * *

(3) QUALIFIED FARM-RELATED TAXPAYER.—

* * *

(B) FARM-RELATED TAXPAYER.—For purposes of this paragraph, the term "farm-related taxpayer" means any taxpayer—

(i) whose principal residence (within the meaning of *section 121*) is on a farm,

(ii) who has a principal occupation of farming, or

(iii) who is a member of the family (within the meaning of subsection (c)(2)(E)) of a taxpayer described in clause (i) or (ii).

* * *

[CCH Explanation at ¶ 129. Committee Reports at ¶ 10,315.]

Amendment Notes

Act Sec. 312(d)(1) amended Code Sec. 464(f)(3)(B)(i) by striking "section 1034" and inserting "section 121".

For the effective date of the above amendment, see Act Sec. 312(d)[(e)], below.

Act Sec. 312(d)[(e)] provides:

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to sales and exchanges after May 6, 1997.

(2) SALES BEFORE DATE OF ENACTMENT.—At the election of the taxpayer, the amendments made by this section shall not apply to any sale or exchange before the date of the enactment of this Act.

(3) CERTAIN SALES WITHIN 2 YEARS AFTER DATE OF ENACTMENT.—Section 121 of the Internal Revenue Code of 1986 (as amended by this section) shall be applied without regard to subsection (c)(2)(B) thereof in the case of any sale or exchange of property during the 2-year period beginning on the date of the enactment of this Act if the taxpayer held such property on the date of the enactment of this Act and fails to meet the ownership and use requirements of subsection (a) thereof with respect to such property.

(4) BINDING CONTRACTS.—At the election of the taxpayer, the amendments made by this section shall not apply to a sale or exchange after the date of the enactment of this Act, if—

(A) such sale or exchange is pursuant to a contract which was binding on such date, or

(B) without regard to such amendments, gain would not be recognized under section 1034 of the Internal Revenue Code of 1986 (as in effect on the day before the date of the enactment of this Act) on such sale or exchange by reason of a new residence acquired on or before such date or with respect to the acquisition of which by the taxpayer a binding contract was in effect on such date.

This paragraph shall not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) of the Internal Revenue Code of 1986 applies to such individual.

[¶ 5167] CODE SEC. 471. GENERAL RULE FOR INVENTORIES.

* * *

(b) ESTIMATES OF INVENTORY SHRINKAGE PERMITTED.—A method of determining inventories shall not be treated as failing to clearly reflect income solely because it utilizes estimates of inventory shrinkage that are confirmed by a physical count only after the last day of the taxable year if—

(1) the taxpayer normally does a physical count of inventories at each location on a regular and consistent basis, and

(2) the taxpayer makes proper adjustments to such inventories and to its estimating methods to the extent such estimates are greater than or less than the actual shrinkage.

Amendment Notes

Act Sec. 961(a) amended Code Sec. 471 by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) a new subsection (b) to read as above.

The above amendment generally applies to tax years ending after the date of the enactment of this Act. For a special rule, see Act Sec. 961(b)(2)(A)-(C), below.

Act Sec. 961(b)(2)(A)-(C) provides:

(2) COORDINATION WITH SECTION 481.—In the case of any taxpayer permitted by this section to change its method of accounting to a permissible method for any taxable year—

(A) such changes shall be treated as initiated by the taxpayer,

(B) such changes shall be treated as made with the consent of the Secretary of the Treasury, and

(C) the period for taking into account the adjustments under section 481 by reason of such change shall be 4 years.

(c) CROSS REFERENCE.—

For rules relating to capitalization of direct and indirect costs of property, see section 263A.

* * *

[CCH Explanation at ¶ 340. Committee Reports at ¶ 10,835.]

Amendment Notes

Act Sec. 961(a) amended Code Sec. 471 by redesignating subsection (b) as subsection (c).

The above amendment generally applies to tax years ending after the date of the enactment of this Act. For a special rule, see Act Sec. 961(b)(2)(A)-(C) in the amendment notes following Code Sec. 471(b).

[¶ 5169] CODE SEC. 475. MARK TO MARKET ACCOUNTING METHOD FOR DEALERS IN SECURITIES.

* * *

(e) ELECTION OF MARK TO MARKET FOR DEALERS IN COMMODITIES.—

(1) IN GENERAL.—In the case of a dealer in commodities who elects the application of this subsection, this section shall apply to commodities held by such dealer in the same manner as this section applies to securities held by a dealer in securities.

(2) COMMODITY.—For purposes of this subsection and subsection (f), the term "commodity" means—

(A) any commodity which is actively traded (within the meaning of section 1092(d)(1));

(B) any notional principal contract with respect to any commodity described in subparagraph (A);

(C) any evidence of an interest in, or a derivative instrument in, any commodity described in subparagraph (A) or (B), including any option, forward contract, futures contract, short position, and any similar instrument in such a commodity; and

(D) any position which—

(i) is not a commodity described in subparagraph (A), (B), or (C),

(ii) is a hedge with respect to such a commodity, and

(iii) is clearly identified in the taxpayer's records as being described in this subparagraph before the close of the day on which it was acquired or entered into (or such other time as the Secretary may by regulations prescribe).

(3) ELECTION.—An election under this subsection may be made without the consent of the Secretary. Such an election, once made, shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

Amendment Notes

Act Sec. 1001(b) amended Code Sec. 475 by redesignating subsection (e) as subsection (g) and by inserting after subsection (d) a new subsection (e) to read as above.

For the effective date of the above amendment, see Act Sec. 1001(d)(4), below.

Act Sec. 1001(d)(4) provides:

(4) ELECTION OF MARK TO MARKER BY SECURITIES TRADERS AND TRADERS AND DEALERS IN COMMIDITIES.—

(A) IN GENERAL.—The amendments made by subsection (b) shall apply to taxable years ending after the date of the enactment of this Act.

(B) 4-YEAR SPREAD OF ADJUSTMENTS.—In the case of a taxpayer who elects under subsection (e) or (f) of section 475 of the Internal Revenue Code of 1986 (as added by this section) to change its method of accounting for the taxable year which includes the date of the enactment of this Act—

(i) any identification required under such subsection with respect to securities and commodities held on the date of the enactment of this Act shall be treated as timely made if made on or before the 30th day after such date of enactment, and

(ii) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of such Code shall be taken into account ratably over the 4-taxable year period beginning with such first taxable year.

(f) ELECTION OF MARK TO MARKET FOR TRADERS IN SECURITIES OR COMMODITIES.—

(1) TRADERS IN SECURITIES.—

(A) IN GENERAL.—In the case of a person who is engaged in a trade or business as a trader in securities and who elects to have this paragraph apply to such trade or business—

(i) such person shall recognize gain or loss on any security held in connection with such trade or business at the close of any taxable year as if such security were sold for its fair market value on the last business day of such taxable year, and

(ii) any gain or loss shall be taken into account for such taxable year.

Proper adjustment shall be made in the amount of any gain or loss subsequently realized for gain or loss taken into account under the preceding sentence. The Secretary may provide by regulations for the application of this subparagraph at times other than the times provided in this subparagraph.

(B) EXCEPTION.—Subparagraph (A) shall not apply to any security—

(i) which is established to the satisfaction of the Secretary as having no connection to the activities of such person as a trader, and

(ii) which is clearly identified in such person's records as being described in clause (i) before the close of the day on which it was acquired, originated, or entered into (or such other time as the Secretary may by regulations prescribe).

If a security ceases to be described in clause (i) at any time after it was identified as such under clause (ii), subparagraph (A) shall apply to any changes in value of the security occurring after the cessation.

(C) COORDINATION WITH SECTION 1259.—Any security to which subparagraph (A) applies and which was acquired in the normal course of the taxpayer's activities as a trader in securities shall not be taken into account in applying section 1259 to any position to which subparagraph (A) does not apply.

(D) OTHER RULES TO APPLY.—Rules similar to the rules of subsections (b)(4) and (d) shall apply to securities held by a person in any trade or business with respect to which an election under this paragraph is in effect.

(2) TRADERS IN COMMODITIES.—In the case of a person who is engaged in a trade or business as a trader in commodities and who elects to have this paragraph apply to such trade or business, paragraph (1) shall apply to commodities held by such trader in connection with such trade or business in the same manner as paragraph (1) applies to securities held by a trader in securities.

(3) ELECTION.—The elections under paragraphs (1) and (2) may be made separately for each trade or business and without the consent of the Secretary. Such an election, once made, shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

Amendment Notes

Act Sec. 1001(b) amended Code Sec. 475 by redesignating subsection (e) as subsection (g) and by inserting after new subsection (e) a new subsection (f) to read as above.

For the effective date of the above amendment, see Act Sec. 1001(d)(4) in the amendment notes following Code Sec. 475(e).

(g) REGULATORY AUTHORITY.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including rules—

(1) to prevent the use of year-end transfers, related parties, or other arrangements to avoid the provisions of this section, and

(2) to provide for the application of this section to any security which is a hedge which cannot be identified with a specific security, position, right to income, or liability.

* * *

[CCH Explanation at ¶ 341. Committee Reports at ¶ 11,120.]

Amendment Notes

Act Sec. 1001(b) amended Code Sec. 475 by redesignating subsection (e) as subsection (g).

For the effective date of the above amendment, see Act Sec. 1001(d)(4) in the amendment notes following Code Sec. 475(e).

[¶ 5171] CODE SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

* * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a):

* * *

(26) Any membership organization if—

(A) such organization is established by a State exclusively to provide coverage for medical care (as defined in section 213(d)) on a not-for-profit basis to individuals described in subparagraph (B) through—

(i) insurance issued by the organization, or

(ii) a health maintenance organization under an arrangement with the organization,

(B) the only individuals receiving such coverage through the organization are individuals—

(i) who are residents of such State, and

(ii) who, by reason of the existence or history of a medical condition—

(I) are unable to acquire medical care coverage for such condition through insurance or from a health maintenance organization, or

(II) are able to acquire such coverage only at a rate which is substantially in excess of the rate for such coverage through the membership organization,

(C) the composition of the membership in such organization is specified by such State, and

(D) no part of the net earnings of the organization inures to the benefit of any private shareholder or individual.

A spouse and any qualifying child (as defined in section 24(c)) of an individual described in subparagraph (B) (without regard to this sentence) shall be treated as described in subparagraph (B).

(27)*(A)* Any membership organization if—

(i) such organization is established before June 1, 1996, by a State exclusively to reimburse its members for losses arising under workmen's compensation acts,

(ii) such State requires that the membership of such organization consist of—

(I) all persons who issue insurance covering workmen's compensation losses in such State, and

(II) all persons and governmental entities who self-insure against such losses, and

(iii) such organization operates as a non-profit organization by—

(I) returning surplus income to its members or workmen's compensation policyholders on a periodic basis, and

(II) reducing initial premiums in anticipation of investment income.

(B) Any organization (including a mutual insurance company) if—

(i) such organization is created by State law and is organized and operated under State law exclusively to—

(I) provide workmen's compensation insurance which is required by State law or with respect to which State law provides significant disincentives if such insurance is not purchased by an employer, and

(II) provide related coverage which is incidental to workmen's compensation insurance,

(ii) such organization must provide workmen's compensation insurance to any employer in the State (for employees in the State or temporarily assigned out-of-State) which seeks such insurance and meets other reasonable requirements relating thereto,

(iii)(I) the State makes a financial commitment with respect to such organization either by extending the full faith and credit of the State to the initial debt of such organization or by providing the initial operating capital of such organization, and (II) in the case of periods after the date of enactment of this subparagraph, the assets of such organization revert to the State upon dissolution or State law does not permit the dissolution of such organization, and

(iv) the majority of the board of directors or oversight body of such organization are appointed by the chief executive officer or other executive branch official of the State, by the State legislature, or by both.

* * *

Amendment Notes

Act Sec. 101(c) amended Code Sec. 501(c)(26) by adding a flush sentence to read as above.

Act Sec. 963(a) amended Code Sec. 501(c)(27) by adding at the end a new subparagraph (B) to read as above.

Act Sec. 963(b) amended Code Sec. 501(c)(27) by inserting "(A)" after "(27)", by redesignating subparagraphs (A), (B), and (C) as clauses (i), (ii), and (iii), respectively, and by redesignating clauses (i) and (ii) of subparagraphs (B) and (C) (before redesignation) as subclauses (I) and (II), respectively.

The above amendments apply to tax years beginning after December 31, 1997.

(e) COOPERATIVE HOSPITAL SERVICE ORGANIZATIONS.—For purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

(1) such organization is organized and operated solely—

(A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing (including the purchasing of insurance on a group basis), warehousing, billing and collection *(including the purchase of patron accounts receivable on a recourse basis)*, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

* * *

Amendment Notes

Act Sec. 974(a) amended Code Sec. 501(e)(1)(A) by inserting "(including the purchase of patron accounts receivable on a recourse basis)" after "billing and collection".

The above amendment applies to tax years beginning after December 31, 1996.

(o) TREATMENT OF HOSPITALS PARTICIPATING IN PROVIDER-SPONSORED ORGANIZATIONS.—An organization shall not fail to be treated as organized and operated exclusively for a charitable purpose for purposes of subsection (c)(3) solely because a hospital which is owned and operated by such organization participates in a provider-sponsored organization (as defined in section 1853(e) of the Social Security Act), whether or not the provider-sponsored organization is exempt from tax. For purposes of subsection (c)(3), any person with a material financial interest in such a provider-sponsored organization shall be treated as a private shareholder or individual with respect to the hospital.

Amendment Notes

Balanced Budget Act

Act Sec. 4041(a) amended Code Sec. 501 by redesignating subsection (o) as subsection (p) and by inserting after subsection (n) a new subsection (o) to read as above.

The above amendment is effective on the date of the enactment of this Act.

(p) CROSS REFERENCE.—

* * *

[CCH Explanation at ¶ 601, 603, 605 and 606. Committee Reports at ¶ 10,125, 10,845, 10,915 and 20,035.]

Amendment Notes

Balanced Budget Act

Act Sec. 4041(a) amended Code Sec. 501 by redesignating subsection (o) as subsection (p).

The above amendment is effective on the date of the enactment of this Act.

[¶ 5173] CODE SEC. 512. UNRELATED BUSINESS TAXABLE INCOME.

(a) DEFINITION.—For purposes of this title—

* * *

(3) SPECIAL RULES APPLICABLE TO ORGANIZATIONS DESCRIBED IN PARAGRAPH (7), (9), (17), OR (20) OF SECTION 501(c).—

* * *

(D) NONRECOGNITION OF GAIN.—If property used directly in the performance of the exempt function of an organization described in paragraph (7), (9), (17), or (20) of section 501(c) is sold by such organization, and within a period beginning 1 year before the date of such sale, and ending 3 years after such date, other property is purchased and used by such organization directly in the performance of its exempt function, gain (if any) from such sale shall be recognized only to the extent that such organization's sales price of the old property exceeds the organization's cost of purchasing the other property. For purposes of this subparagraph, the destruction in whole or in part, theft, seizure, requisition, or condemnation of property, shall be treated as the sale of such property, and rules similar to the rules provided by subsections (b), (c), (e), and (j) of section 1034 *(as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997)* shall apply.

* * *

Amendment Notes

Act Sec. 312(d)(5) amended Code Sec. 512(a)(3)(D) by inserting "(as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997)" after "1034".

For the effective date of the above amendment, see Act Sec. 312(d)[(e)], below.

Act Sec. 312(d)[(e)] provides:

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to sales and exchanges after May 6, 1997.

(2) SALES BEFORE DATE OF ENACTMENT.—At the election of the taxpayer, the amendments made by this section shall not apply to any sale or exchange before the date of the enactment of this Act.

(3) CERTAIN SALES WITHIN 2 YEARS AFTER DATE OF ENACTMENT.—Section 121 of the Internal Revenue Code of 1986 (as amended by this section) shall be applied without regard to subsection (c)(2)(B) thereof in the case of any sale or exchange of property during the 2-year period beginning on the date of the enactment of this Act if the taxpayer held such property on the date of the enactment of this Act and fails to meet the ownership and use requirements of subsection (a) thereof with respect to such property.

(4) BINDING CONTRACTS—At the election of the taxpayer, the amendments made by this section shall not apply to a sale or exchange after the date of the enactment of this Act, if—

(A) such sale or exchange is pursuant to a contract which was binding on such date, or

(B) without regard to such amendments gain would not be recognized under section 1034 of the Internal Revenue Code of 1986 (as in effect on the day before the date of the enactment of this Act) on such sale or exchange by reason of a new residence acquired on or before such date or with respect to the acquisition of which by the taxpayer a binding contract was in effect on such date.

This paragraph shall not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) of the Internal Revenue Code of 1986 applies to such individual.

(b) MODIFICATIONS.—The modifications referred to in subsection (a) are the following:

* * *

(13) SPECIAL RULES FOR CERTAIN AMOUNTS RECEIVED FROM CONTROLLED ENTITIES.—

(A) IN GENERAL.—If an organization (in this paragraph referred to as the "controlling organization") receives (directly or indirectly) a specified payment from another entity which it controls (in this paragraph referred to as the "controlled entity"), notwithstanding paragraphs (1), (2), and (3), the controlling organization shall include such payment as an item of gross income derived from an unrelated trade or business to the extent such payment reduces the net unrelated income of the controlled entity (or increases any net unrelated loss of the controlled entity). There shall be allowed all deductions of the controlling organization directly connected with amounts treated as derived from an unrelated trade or business under the preceding sentence.

(B) NET UNRELATED INCOME OR LOSS.—For purposes of this paragraph—

(i) NET UNRELATED INCOME.—The term "net unrelated income" means—

(I) in the case of a controlled entity which is not exempt from tax under section 501(a), the portion of such entity's taxable income which would be unrelated business taxable income if such entity were exempt from tax under section 501(a) and had the same exempt purposes (as defined in section 513A(a)(5)(A)) as the controlling organization, or

(II) in the case of a controlled entity which is exempt from tax under section 501(a), the amount of the unrelated business taxable income of the controlled entity.

(ii) NET UNRELATED LOSS.—The term "net unrelated loss" means the net operating loss adjusted under rules similar to the rules of clause (i).

(C) SPECIFIED PAYMENT.—For purposes of this paragraph, the term "specified payment" means any interest, annuity, royalty, or rent.

(D) DEFINITION OF CONTROL.—For purposes of this paragraph—

(i) CONTROL.—The term "control" means—

(I) in the case of a corporation, ownership (by vote or value) of more than 50 percent of the stock in such corporation,

(II) in the case of a partnership, ownership of more than 50 percent of the profits interests or capital interests in such partnership, or

(III) in any other case, ownership of more than 50 percent of the beneficial interests in the entity.

(ii) CONSTRUCTIVE OWNERSHIP.—Section 318 (relating to constructive ownership of stock) shall apply for purposes of determining ownership of stock in a corporation. Similar principles shall apply for purposes of determining ownership of interests in any other entity.

(E) RELATED PERSONS.—The Secretary shall prescribe such rules as may be necessary or appropriate to prevent avoidance of the purposes of this paragraph through the use of related persons.

* * *

Amendment Notes

Act Sec. 1041(a) amended Code Sec. 512(b)(13) to read as above. Prior to amendment, Code Sec. 512(b)(13) read as follows:

(13) Notwithstanding paragraphs (1), (2), or (3), amounts of interest, annuities, royalties, and rents derived from any organization (in this paragraph called the "controlled organization") of which the organization deriving such amounts (in this paragraph called the "controlling organization") has control (as defined in section 368(c)) shall be included as an item of gross income (whether or not the activity from which such amounts are derived represents a trade or business or is regularly carried on) in an amount which bears the same ratio as—

(A) (i) in the case of a controlled organization which is not exempt from taxation under section 501(a), the excess of the amount of taxable income of the controlled organization over the amount of such organization's taxable income which if derived directly by the controlling organization would not be unrelated business taxable income, or

(ii) in the case of a controlled organization which is exempt from taxation under section 501(a), the amount of unrelated business taxable income of the controlled organization, bears to

(B) the taxable income of the controlled organization (determined in the case of a controlled organization to which subparagraph (A)(ii) applies as if it were not an organization exempt from taxation under section 501(a)), but not less than the amount determined in clause (i) or (ii), as the case may be, of subparagraph (A),

both amounts computed without regard to amounts paid directly or indirectly to the controlling organization. There shall be allowed all deductions directly connected with amounts included in gross income under the preceding sentence.

The above amendment generally applies to tax years beginning after the date of the enactment of this Act. For a special rule, see Act Sec. 1041(b)(2), below.

Act Sec. 1041(b)(2) provides:

(2) BINDING CONTRACTS.—The amendments made by this section shall not apply to any payment made during the first 2 taxable years beginning on or after the date of the enactment of this Act if such payment is made pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such payment.

(e) SPECIAL RULES APPLICABLE TO S CORPORATIONS.—

(1) IN GENERAL.—If an organization described in *section 1361(c)(6)* holds stock in an S corporation—

(A) such interest shall be treated as an interest in an unrelated trade or business; and

(B) notwithstanding any other provision of this part—

(i) all items of income, loss, or deduction taken into account under section 1366(a), and

(ii) any gain or loss on the disposition of the stock in the S corporation

shall be taken into account in computing the unrelated business taxable income of such organization.

(2) BASIS REDUCTION.—Except as provided in regulations, for purposes of paragraph (1), the basis of any stock acquired by purchase (*as defined in section 1361(e)(1)(C)*) shall be reduced by the amount of any dividends received by the organization with respect to the stock.

(3) EXCEPTION FOR ESOPS.—This subsection shall not apply to employer securities (within the meaning of section 409(l)) held by an employee stock ownership plan described in section 4975(e)(7).

[CCH Explanation at ¶ 129, 613 and 755. Committee Reports at ¶ 10,315, 11,335 and 13,355.]

Amendment Notes

Act Sec. 1523(a) amended Code Sec. 512(e) by adding at the end a new paragraph (3) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

Act Sec. 1601(c)(4)(A) amended Code Sec. 512(e)(2) by striking "within the meaning of section 1012" and inserting "as defined in section 1361(e)(1)(C)".

Act Sec. 1601(c)(4)(D) amended Code Sec. 512(e)(1) by striking "section 1361(c)(7)" and inserting "section 1361(c)(6)".

The above amendments are effective as if included in the provisions of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which they relate [effective for tax years beginning after December 31, 1997.—CCH.].

[¶ 5175] CODE SEC. 513. UNRELATED TRADE OR BUSINESS.

* * *

(i) TREATMENT OF CERTAIN SPONSORSHIP PAYMENTS.—

(1) IN GENERAL.—The term "unrelated trade or business" does not include the activity of soliciting and receiving qualified sponsorship payments.

(2) QUALIFIED SPONSORSHIP PAYMENTS.—For purposes of this subsection—

(A) IN GENERAL.—The term "qualified sponsorship payment" means any payment made by any person engaged in a trade or business with respect to which there is no arrangement or expectation that such person will receive any substantial return benefit other than the use or acknowledgement of the name or logo (or product lines) of such person's trade or business in connection with the activities of the organization that receives such payment. Such a use or acknowledgement does not include advertising such person's products or services (including messages containing qualitative or comparative language, price information, or other indications of savings or value, an endorsement, or an inducement to purchase, sell, or use such products or services).

(B) LIMITATIONS.—

(i) CONTINGENT PAYMENTS.—The term "qualified sponsorship payment" does not include any payment if the amount of such payment is contingent upon the level of attendance at one or more events, broadcast ratings, or other factors indicating the degree of public exposure to one or more events.

(ii) SAFE HARBOR DOES NOT APPLY TO PERIODICALS AND QUALIFIED CONVENTION AND TRADE SHOW ACTIVITIES.—The term "qualified sponsorship payment" does not include—

(I) any payment which entitles the payor to the use or acknowledgement of the name or logo (or product lines) of the payor's trade or business in regularly scheduled and printed material published by or on behalf of the payee organization that is not related to and primarily distributed in connection with a specific event conducted by the payee organization, or

(II) any payment made in connection with any qualified convention or trade show activity (as defined in subsection (d)(3)(B)).

(3) ALLOCATION OF PORTIONS OF SINGLE PAYMENT.—For purposes of this subsection, to the extent that a portion of a payment would (if made as a separate payment) be a qualified sponsorship payment, such portion of such payment and the other portion of such payment shall be treated as separate payments.

* * *

[CCH Explanation at ¶ 611. Committee Reports at ¶ 10,855.]

Amendment Notes

Act Sec. 965(a) amended Code Sec. 513 by adding at the end thereof a new subsection (i) to read as above.

The above amendment applies to payments solicited or received after December 31, 1997.

[¶ 5177] CODE SEC. 528. CERTAIN HOMEOWNERS ASSOCIATIONS.

* * *

(b) TAX IMPOSED.—A tax is hereby imposed for each taxable year on the homeowners association taxable income of every homeowners association. Such tax shall be equal to 30 percent of the homeowners association taxable income *(32 percent of such income in the case of a timeshare association).*

Amendment Notes

Act Sec. 966(d) amended Code Sec. 528(b) by inserting before the period "(32 percent of such income in the case of a timeshare association)".

The above amendment applies to tax years beginning after December 31, 1996.

(c) HOMEOWNERS ASSOCIATION DEFINED.—For purposes of this section—

(1) HOMEOWNERS ASSOCIATION.—The term "homeowners association" means an organization which is a condominium management association, *a residential real estate management association, or a timeshare association* if—

(A) such organization is organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property,

(B) 60 percent or more of the gross income of such organization for the taxable year consists solely of amounts received as membership dues, fees, or assessments from—

(i) owners of residential units in the case of a condominium management association,

(ii) owners of residences or residential lots in the case of a residential real estate management association, *or*

(iii) owners of timeshare rights to use, or timeshare ownership interests in, association property in the case of a timeshare association,

(C) 90 percent or more of the expenditures of the organization for the taxable year are expenditures for the acquisition, construction, management, maintenance, and care of association property *and, in the case of a timeshare association, for activities provided to or on behalf of members of the association,*

(D) no part of the net earnings of such organization inures (other than by acquiring, constructing, or providing management, maintenance, and care of association property, and other than by a rebate of excess membership dues, fees, or assessments) to the benefit of any private shareholder or individual, and

(E) such organization elects (at such time and in such manner as the Secretary by regulations prescribes) to have this section apply for the taxable year.

* * *

(4) TIMESHARE ASSOCIATION.—The term "timeshare association" means any organization (other than a condominium management association) meeting the requirement of subparagraph (A) of paragraph (1) if any member thereof holds a timeshare right to use, or a timeshare ownership interest in, real property constituting association property.

(5) ASSOCIATION PROPERTY.—The term "association property" means—

(A) property held by the organization,

(B) property commonly held by the members of the organization,

(C) property within the organization privately held by the members of the organization, and

(D) property owned by a governmental unit and used for the benefit of residents of such unit.

In the case of a timeshare association, such term includes property in which the timeshare association, or members of the association, have rights arising out of recorded easements, covenants, or other recorded instruments to use property related to the timeshare project.

Amendment Notes

Act Sec. 966(a)(1)(A) amended Code Sec. 528(c)(1) by striking "or a residential real estate management association" and inserting ", a residential real estate management association, or a timeshare association" in the material preceding subparagraph (A).

Act Sec. 966(a)(1)(B) amended Code Sec. 528(c)(1)(B) by striking "or" at the end of clause (i), by striking the period at the end of clause (ii) and inserting ", or", and by adding at the end a new clause (iii) to read as above.

Act Sec. 966(a)(1)(C) amended Code Sec. 528(c)(1)(C) by inserting "and, in the case of a timeshare association, for activities provided to or on behalf of members of the association" before the comma at the end.

Act Sec. 966(a)(2) amended Code Sec. 528(c) by redesignating paragraph (4) as paragraph (5) and by inserting after paragraph (3) a new paragraph (4) to read as above.

Act Sec. 966(c) amended Code Sec. 528(c)(5), as redesignated by Act Sec. 966(a)(2), by adding at the end a new flush sentence to read as above.

The above amendments apply to tax years beginning after December 31, 1996.

(d) HOMEOWNERS ASSOCIATION TAXABLE INCOME DEFINED.—

* * *

(3) EXEMPT FUNCTION INCOME.—For purposes of this subsection, the term "exempt function income" means any amount received as membership dues, fees, or assessments from—

(A) owners of condominium housing units in the case of a condominium management association,

(B) owners of real property in the case of a residential real estate management association, *or*

(C) owners of timeshare rights to use, or timeshare ownership interests in, real property in the case of a timeshare association.

[CCH Explanation at ¶ 616. Committee Reports at ¶ 10,860.]

Amendment Notes

Act Sec. 966(b) amended Code Sec. 528(d)(3) by striking "or" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", or", and by adding at the end a new subparagraph (C) to read as above.

The above amendment applies to tax years beginning after December 31, 1996.

[¶ 5179] CODE SEC. 529. QUALIFIED STATE TUITION PROGRAMS.

* * *

(b) QUALIFIED STATE TUITION PROGRAM.—For purposes of this section—

* * *

(5) NO INVESTMENT DIRECTION.—A program shall not be treated as a qualified State tuition program unless it provides that any contributor to, or designated beneficiary under, such program may not *directly or indirectly* direct the investment of any contributions to the program (or any earnings thereon).

* * *

Amendment Notes

Act Sec. 211(b)(4) amended Code Sec. 529(b)(5) by inserting "directly or indirectly" after "may not".

The above amendment is effective on January 1, 1998.

(c) TAX TREATMENT OF DESIGNATED BENEFICIARIES AND CONTRIBUTORS.—

* * *

(2) GIFT TAX TREATMENT OF CONTRIBUTIONS.—For purposes of chapters 12 and 13—

(A) IN GENERAL.—Any contribution to a qualified tuition program on behalf of any designated beneficiary—

(i) shall be treated as a completed gift to such beneficiary which is not a future interest in property, and

(ii) shall not be treated as a qualified transfer under section 2503(e).

(B) TREATMENT OF EXCESS CONTRIBUTIONS.—If the aggregate amount of contributions described in subparagraph (A) during the calendar year by a donor exceeds the limitation for such year under

section 2503(b), such aggregate amount shall, at the election of the donor, be taken into account for purposes of such section ratably over the 5-year period beginning with such calendar year.

(3) DISTRIBUTIONS.—

(A) IN GENERAL.—Any distribution under a qualified State tuition program shall be includible in the gross income of the distributee in the manner as provided under *section 72(b)* to the extent not excluded from gross income under any other provision of this chapter.

* * *

(4) ESTATE TAX TREATMENT.—

(A) IN GENERAL.—No amount shall be includible in the gross estate of any individual for purposes of chapter 11 by reason of an interest in a qualified tuition program.

(B) AMOUNTS INCLUDIBLE IN ESTATE OF DESIGNATED BENEFICIARY IN CERTAIN CASES.—Subparagraph (A) shall not apply to amounts distributed on account of the death of a beneficiary.

(C) AMOUNTS INCLUDIBLE IN ESTATE OF DONOR MAKING EXCESS CONTRIBUTIONS.—In the case of a donor who makes the election described in paragraph (2)(B) and who dies before the close of the 5-year period referred to in such paragraph, notwithstanding subparagraph (A), the gross estate of the donor shall include the portion of such contributions properly allocable to periods after the date of death of the donor.

(5) OTHER GIFT TAX RULES.—For purposes of chapters 12 and 13—

(A) TREATMENT OF DISTRIBUTIONS.—Except as provided in subparagraph (B), in no event shall a distribution from a qualified tuition program be treated as a taxable gift.

(B) TREATMENT OF DESIGNATION OF NEW BENEFICIARY.—The taxes imposed by chapters 12 and 13 shall apply to a transfer by reason of a change in the designated beneficiary under the program (or a rollover to the account of a new beneficiary) only if the new beneficiary is a generation below the generation of the old beneficiary (determined in accordance with section 2651).

Amendment Notes

Act Sec. 211(b)(3)(A)(i) amended Code Sec. 529(c)(2) to read as above. Prior to amendment, Code Sec. 529(c)(2) read as follows:

(2) CONTRIBUTIONS.—In no event shall a contribution to a qualified State tuition program on behalf of a designated beneficiary be treated as a taxable gift for purposes of chapter 12.

Act Sec. 211(b)(3)(A)(ii) amended Code Sec. 529(c)(5) to read as above. Prior to amendment, Code Sec. 529(c)(5) read as follows:

(5) SPECIAL RULE FOR APPLYING SECTION 2503(e).—For purposes of section 2503(e), the waiver (or payment to an educational institution) of qualified higher education expenses of a designated beneficiary under a qualified State tuition program shall be treated as a qualified transfer.

The above amendments apply to transfers (including designations of new beneficiaries) made after the date of the enactment of this Act.

Act Sec. 211(b)(3)(B) amended Code Sec. 529(c)(4) to read as above. Prior to amendment, Code Sec. 529(c)(4) read as follows:

(4) ESTATE TAX INCLUSION.—The value of any interest in any qualified State tuition program which is attributable to contributions made by an individual to such program on behalf of any designated beneficiary shall be includible in the gross estate of the contributor for purposes of chapter 11.

The above amendment applies to estates of decedents dying after June 8, 1997.

Act Sec. 211(d) amended Code Sec. 529(c)(3)(A) by striking "section 72" and inserting "section 72(b)".

The above amendment is generally effective on January 1, 1998.

Act Sec. 211(f)(6) provides:

(6) TRANSITION RULE FOR PRE-AUGUST 20, 1996 CONTRACTS.—In the case of any contract issued prior to August 20, 1996, section 529(c)(3)(C) of the Internal Revenue Code of 1986 shall be applied for taxable years ending after August 20, 1996, without regard to the requirement that a distribution be transferred to a member of the family or the requirement that a change in beneficiaries may be made only to a member of the family.

(d) REPORTS.—Each officer or employee having control of the qualified State tuition program or their designee shall make such reports regarding such program to the Secretary and to designated beneficiaries with respect to contributions, distributions, and such other matters as the Secretary may require. The reports required by this subsection shall be filed at such time and in such manner and furnished to such individuals at such time and in such manner as may be required by the Secretary.

Amendment Notes

Act Sec. 211(e)(2)(A) amended Code Sec. 529(d) to read as above. Prior to amendment, Code Sec. 529(d) read as follows:

(d) REPORTING REQUIREMENTS.—

(1) IN GENERAL.—If there is a distribution to any individual with respect to an interest in a qualified State tuition program during any calendar year, each officer or employee having control of the qualified State tuition program or their designee shall make such reports as the Secretary may require regarding such distribution to the Secretary and to the designated beneficiary or the individual to whom the distribution was made. Any such report shall include such information as the Secretary may prescribe.

(2) TIMING OF REPORTS.—Any report required by this subsection—

(A) shall be filed at such time and in such matter as the Secretary prescribes, and

(B) shall be furnished to individuals not later than January 31 of the calendar year following the calendar year to which such report relates.

The above amendment is effective on January 1, 1998.

(e) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) DESIGNATED BENEFICIARY.—The term "designated beneficiary" means—

(A) the individual designated at the commencement of participation in the qualified State tuition program as the beneficiary of amounts paid (or to be paid) to the program,

(B) in the case of a change in beneficiaries described in *subsection (c)(3)(C)*, the individual who is the new beneficiary, and

(C) in the case of an interest in a qualified State tuition program purchased by a State or local government *(or agency or instrumentality thereof)* or an organization described in section 501(c)(3) and exempt from taxation under section 501(a) as part of a scholarship program operated by such government or organization, the individual receiving such interest as a scholarship.

(2) MEMBER OF FAMILY.—The term "member of the family" means—

(A) an individual who bears a relationship to another individual which is a relationship described in paragraphs (1) through (8) of section 152(a), and

(B) the spouse of any individual described in subparagraph (A).

(3) QUALIFIED HIGHER EDUCATION EXPENSES.—

(A) IN GENERAL.—The term "qualified higher education expenses" means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution.

(B) ROOM AND BOARD INCLUDED FOR STUDENTS UNDER GUARANTEED PLANS WHO ARE AT LEAST HALF-TIME.—

(i) IN GENERAL.—In the case of an individual who is an eligible student (as defined in section 25A(b)(3)) for any academic period, such term shall also include reasonable costs for such period (as determined under the qualified State tuition program) incurred by the designated beneficiary for room and board while attending such institution. For purposes of subsection (b)(7), a designated beneficiary shall be treated as meeting the requirements of this clause.

(ii) LIMITATION.—The amount treated as qualified higher education expenses by reason of the preceding sentence shall not exceed the minimum amount (applicable to the student) included for room and board for such period in the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll, as in effect on the date of the enactment of this paragraph) for the eligible educational institution for such period.

* * *

(5) ELIGIBLE EDUCATIONAL INSTITUTION.—The term "eligible educational institution" means an institution—

(A) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on the date of the enactment of this paragraph, and

(B) which is eligible to participate in a program under title IV of such Act.

[CCH Explanation at ¶ 149. Committee Reports at ¶ 10,175.]

Amendment Notes

Act Sec. 211(a) amended Code Sec. 529(e)(3) to read as above. Prior to amendment, Code Sec. 529(e)(3) read as follows:

(3) QUALIFIED HIGHER EDUCATION EXPENSES.—The term "qualified higher education expenses" means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution (as defined in section 135(c)(3)).

The above amendment is effective as if included in the amendments made by Act Sec. 1806 of the Small Business Job Protection Act of 1996 (P.L. 104-188) [generally effective for tax years ending after August 20, 1996.—CCH.].

Act Sec. 211(b)(1) amended Code Sec. 529(e)(2) to read as above. Prior to amendment, Code Sec. 529(e)(2) read as follows:

(2) MEMBER OF FAMILY.—The term "member of the family" has the same meaning given such term as section 2032A(e)(2).

The above amendment is effective on January 1, 1998.

Act Sec. 211(b)(2) amended Code Sec. 529(e) by adding a new paragraph (5) to read as above.

The above amendment applies to distributions after December 31, 1997, with respect to expenses paid after such date (in tax years ending after such date), for education furnished in academic periods beginning after such date.

Act Sec. 211(f)(6) provides:

(6) TRANSITION RULE FOR PRE-AUGUST 20, 1996 CONTRACTS.—In the case of any contract issued prior to August 20, 1996, section 529(c)(3)(C) of the Internal Revenue Code of 1986 shall be applied for taxable years ending after August 20, 1996, without regard to the requirement that a distribution be transferred to a member of the family or the requirement that a change in beneficiaries may be made only to a member of the family.

Act Sec. 1601(h)(1)(A) amended Code Sec. 529(e)(1)(B) by striking "subsection (c)(2)(C)" and inserting "subsection (c)(3)(C)".

Act Sec. 1601(h)(1)(B) amended Code Sec. 529(e)(1)(C) by inserting "(or agency or instrumentality thereof)" after "local government".

The above amendments are effective as if included in the provisions of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which they relate [generally effective for tax years ending after August 20, 1996.—CCH.].

[¶ 5181] *CODE SEC. 530. EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.*

(a) GENERAL RULE.—An education individual retirement account shall be exempt from taxation under this subtitle. Notwithstanding the preceding sentence, the education individual retirement account shall be subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable organizations).

(b) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) EDUCATION INDIVIDUAL RETIREMENT ACCOUNT.—The term "education individual retirement account" means a trust created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses of the designated beneficiary of the trust (and designated as an education individual retirement account at the time created or organized), but only if the written governing instrument creating the trust meets the following requirements:

(A) No contribution will be accepted—

(i) unless it is in cash,

(ii) after the date on which such beneficiary attains age 18, or

(iii) except in the case of rollover contributions, if such contribution would result in aggregate contributions for the taxable year exceeding $500.

(B) The trustee is a bank (as defined in section 408(n)) or another person who demonstrates to the satisfaction of the Secretary that the manner in which that person will administer the trust will be consistent with the requirements of this section or who has so demonstrated with respect to any individual retirement plan.

(C) No part of the trust assets will be invested in life insurance contracts.

(D) The assets of the trust shall not be commingled with other property except in a common trust fund or common investment fund.

(E) Upon the death of the designated beneficiary, any balance to the credit of the beneficiary shall be distributed within 30 days after the date of death to the estate of such beneficiary.

(2) QUALIFIED HIGHER EDUCATION EXPENSES.—

(A) IN GENERAL.—The term "qualified higher education expenses" has the meaning given such term by section 529(e)(3), reduced as provided in section 25A(g)(2).

(B) QUALIFIED STATE TUITION PROGRAMS.—Such term shall include amounts paid or incurred to purchase tuition credits or certificates, or to make contributions to an account, under a qualified State tuition program (as defined in section 529(b)) for the benefit of the beneficiary of the account.

(3) ELIGIBLE EDUCATIONAL INSTITUTION.—The term "eligible educational institution" has the meaning given such term by section 529(e)(5).

(c) REDUCTION IN PERMITTED CONTRIBUTIONS BASED ON ADJUSTED GROSS INCOME.—

(1) IN GENERAL.—The maximum amount which a contributor could otherwise make to an account under this section shall be reduced by an amount which bears the same ratio to such maximum amount as—

(A) the excess of—

(i) the contributor's modified adjusted gross income for such taxable year, over

(ii) $95,000 ($150,000 in the case of a joint return), bears to

(B) $15,000 ($10,000 in the case of a joint return).

(2) MODIFIED ADJUSTED GROSS INCOME.—For purposes of paragraph (1), the term "modified adjusted gross income" means the adjusted gross income of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933.

(d) TAX TREATMENT OF DISTRIBUTIONS.—

(1) IN GENERAL.—Any distribution shall be includible in the gross income of the distributee in the manner as provided in section 72(b).

(2) DISTRIBUTIONS FOR QUALIFIED HIGHER EDUCATION EXPENSES.—

(A) IN GENERAL.—No amount shall be includible in gross income under paragraph (1) if the qualified higher education expenses of the designated beneficiary during the taxable year are not less than the aggregate distributions during the taxable year.

(B) DISTRIBUTIONS IN EXCESS OF EXPENSES.—If such aggregate distributions exceed such expenses during the taxable year, the amount otherwise includible in gross income under paragraph (1) shall be reduced by the amount which bears the same ratio to the amount which would be includible in gross income under paragraph (1) (without regard to this subparagraph) as the qualified higher education expenses bear to such aggregate distributions.

(C) ELECTION TO WAIVE EXCLUSION.—A taxpayer may elect to waive the application of this paragraph for any taxable year.

(3) SPECIAL RULES FOR APPLYING ESTATE AND GIFT TAXES WITH RESPECT TO ACCOUNT.—Rules similar to the rules of paragraphs (2), (4), and (5) of section 529(c) shall apply for purposes of this section.

(4) ADDITIONAL TAX FOR DISTRIBUTIONS NOT USED FOR EDUCATIONAL EXPENSES.—

(A) IN GENERAL.—The tax imposed by this chapter for any taxable year on any taxpayer who receives a payment or distribution from an education individual retirement account which is includible in gross income shall be increased by 10 percent of the amount which is so includible.

(B) EXCEPTIONS.—Subparagraph (A) shall not apply if the payment or distribution is—

(i) made to a beneficiary (or to the estate of the designated beneficiary) on or after the death of the designated beneficiary,

(ii) attributable to the designated beneficiary's being disabled (within the meaning of section 72(m)(7)), or

(iii) made on account of a scholarship, allowance, or payment described in section 25A(g)(2) received by the account holder to the extent the amount of the payment or distribution does not exceed the amount of the scholarship, allowance, or payment.

(C) EXCESS CONTRIBUTIONS RETURNED BEFORE DUE DATE OF RETURN.—Subparagraph (A) shall not apply to the distribution of any contribution made during a taxable year on behalf of a designated beneficiary to the extent that such contribution exceeds $500 if—

(i) such distribution is received on or before the day prescribed by law (including extensions of time) for filing such contributor's return for such taxable year, and

(ii) such distribution is accompanied by the amount of net income attributable to such excess contribution.

Any net income described in clause (ii) shall be included in gross income for the taxable year in which such excess contribution was made.

(5) ROLLOVER CONTRIBUTIONS.—Paragraph (1) shall not apply to any amount paid or distributed from an education individual retirement account to the extent that the amount received is paid into another education individual retirement account for the benefit of the same beneficiary or a member of the family (within the meaning of section 529(e)(2)) of such beneficiary not later than the 60th day after the date of such payment or distribution. The preceding sentence shall not apply to any payment or distribution if it applied to any prior payment or distribution during the 12-month period ending on the date of the payment or distribution.

(6) CHANGE IN BENEFICIARY.—Any change in the beneficiary of an education individual retirement account shall not be treated as a distribution for purposes of paragraph (1) if the new beneficiary is a member of the family (as so defined) of the old beneficiary.

(7) SPECIAL RULES FOR DEATH AND DIVORCE.—Rules similar to the rules of paragraphs (7) and (8) of section 220(f) shall apply.

(e) TAX TREATMENT OF ACCOUNTS.—Rules similar to the rules of paragraphs (2) and (4) of section 408(e) shall apply to any education individual retirement account.

(f) COMMUNITY PROPERTY LAWS.—This section shall be applied without regard to any community property laws.

(g) CUSTODIAL ACCOUNTS.—For purposes of this section, a custodial account shall be treated as a trust if the assets of such account are held by a bank (as defined in section 408(n)) or another person who demonstrates, to the satisfaction of the Secretary, that the manner in which he will administer the account will be consistent with the requirements of this section, and if the custodial account would, except for the fact that it is not a trust, constitute an account described in subsection (b)(1). For purposes of this

title, in the case of a custodial account treated as a trust by reason of the preceding sentence, the custodian of such account shall be treated as the trustee thereof.

(h) Reports.—The trustee of an education individual retirement account shall make such reports regarding such account to the Secretary and to the beneficiary of the account with respect to contributions, distributions, and such other matters as the Secretary may require. The reports required by this subsection shall be filed at such time and in such manner and furnished to such individuals at such time and in such manner as may be required.

* * *

[CCH Explanation at ¶ 145. Committee Reports at ¶ 10,185.]

Amendment Notes

Act Sec. 213(a) amended part VIII of subchapter F of chapter 1 by adding at the end a new Code Sec. 530 to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5183] CODE SEC. 532. CORPORATIONS SUBJECT TO ACCUMULATED EARNINGS TAX.

* * *

(b) Exceptions.—The accumulated earnings tax imposed by section 531 shall not apply to—

(1) a personal holding company (as defined in section 542),

(2) a foreign personal holding company (as defined in section 552),

(3) a corporation exempt from tax under subchapter F (section 501 and following), or

(4) a passive foreign investment company (as defined in *section 1297*).

* * *

[CCH Explanation at ¶ 946. Committee Reports at ¶ 11,690.]

Amendment Notes

Act Sec. 1122(d)(1) amended Code Sec. 532(b)(4) by striking "section 1296" and inserting "section 1297".

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and tax years of foreign corporations ending with or within such tax years of United States persons.

[¶ 5185] CODE SEC. 542. DEFINITION OF PERSONAL HOLDING COMPANY.

* * *

(c) Exceptions.—The term "personal holding company" as defined in subsection (a) does not include—

* * *

(10) a passive foreign investment company (as defined in *section 1297*).

* * *

[CCH Explanation at ¶ 946. Committee Reports at ¶ 11,690.]

Amendment Notes

Act Sec. 1122(d)(1) amended Code Sec. 542(c)(10) by striking "section 1296" and inserting "section 1297".

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and tax years of foreign corporations ending with or within such tax years of United States persons.

[¶ 5187] CODE SEC. 551. FOREIGN PERSONAL HOLDING COMPANY INCOME TAXED TO UNITED STATES SHAREHOLDERS.

* * *

(f) Stock Held Through Foreign Entity.—For purposes of this section, stock of a foreign personal holding company owned (directly or through the application of this subsection) by—

(1) a foreign partnership or an estate or trust which is a foreign estate or trust, or

(2) a foreign corporation which is not a foreign personal holding company, shall be considered as being owned proportionately by its partners, beneficiaries, or shareholders. In any case to which the preceding sentence applies, the Secretary may by regulations provide that rules similar to the rules of *section 1298(b)(5)* shall apply, and provide for such other adjustments in the application of this subchapter as may be necessary to carry out the purposes of this subsection.

* * *

[CCH Explanation at ¶ 946. Committee Reports at ¶ 11,690.]

Amendment Notes

Act Sec. 1122(d)(2) amended Code Sec. 551(f) by striking "section 1297(b)(5)" and inserting "section 1298(b)(5)".

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and tax years of foreign corporations ending with or within such tax years of United States persons.

[¶ 5189] CODE SEC. 593. RESERVES FOR LOSSES ON LOANS.

* * *

(e) DISTRIBUTIONS TO SHAREHOLDERS.—

(1) IN GENERAL.—For purposes of this chapter, any distribution of property (as defined in section 317(a)) by a taxpayer having a balance described in subsection (g)(2)(A)(ii) to a shareholder with respect to its stock, if such distribution is not allowable as a deduction under section 591, shall be treated as made—

(A) first out of its earnings and profits accumulated in taxable years beginning after December 31, 1951, *(and, in the case of an S corporation, the accumulated adjustments account, as defined in section 1368(e)(1))* to the extent thereof,

(B) then out of the balance taken into account under subsection (g)(2)(A)(ii) (properly adjusted for amounts charged against such reserves for taxable years beginning after December 31, 1987),

(C) then out of the supplemental reserve for losses on loans, to the extent thereof,

(D) then out of such other accounts as may be proper.

This paragraph shall apply in the case of any distribution in redemption of stock or in partial or complete liquidation of a taxpayer having a balance described in subsection (g)(2)(A)(ii), except that any such distribution shall be treated as made first out of the amount referred to in subparagraph (B), second out of the amount referred to in subparagraph (C), third out of the amount referred to in subparagraph (A), and then out of such other accounts as may be proper. This paragraph shall not apply to any transaction to which section 381 applies, or to any distribution to the Federal Savings and Loan Insurance Corporation (or any successor thereof) or the Federal Deposit Insurance Corporation in redemption of an interest in a taxpayer having a balance described in subsection (g)(2)(A)(ii), if such interest was originally received by any such entity in exchange for assistance provided under a provision of law referred to in section 597(c). This paragraph shall not apply to any distribution of all of the stock of a bank (as defined in section 581) to another corporation if, immediately after the distribution, such bank and such other corporation are members of the same affiliated group (as defined in section 1504) and the provisions of section 5(e) of the Federal Deposit Insurance Act (as in effect on December 31, 1995) or similar provisions are in effect.

* * *

[CCH Explanation at ¶ 573. Committee Reports at ¶ 13,665.]

Amendment Notes

Act Sec. 1601(f)(5)(A) amended Code Sec. 593(e)(1)(A) by inserting "(and, in the case of an S corporation, the accumulated adjustments account, as defined in section 1368(e)(1))" after "1951,".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years beginning after December 31, 1995.—CCH.].

[¶ 5191] CODE SEC. 613A. LIMITATIONS ON PERCENTAGE DEPLETION IN CASE OF OIL AND GAS WELLS.

* * *

(c) EXEMPTION FOR INDEPENDENT PRODUCERS AND ROYALTY OWNERS.—

* * *

(6) OIL AND NATURAL GAS PRODUCED FROM MARGINAL PROPERTIES.—

* * *

(H) TEMPORARY SUSPENSION OF TAXABLE INCOME LIMIT WITH RESPECT TO MARGINAL PRODUCTION.—The second sentence of subsection (a) of section 613 shall not apply to so much of the allowance for depletion as is determined under subparagraph (A) for any taxable year beginning after December 31, 1997, and before January 1, 2000.

* * *

[CCH Explanation at ¶ 326. Committee Reports at ¶ 10,890.]

Amendment Notes

Act Sec. 972(a) amended Code Sec. 613A(c)(6) by adding at the end a new subparagraph (H) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5193] CODE SEC. 641. IMPOSITION OF TAX.

* * *

(b) COMPUTATION AND PAYMENT.—The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part. The tax shall be computed on such taxable income and shall be paid by the fiduciary. *For purposes of this subsection, a foreign trust or foreign estate shall be treated as a nonresident alien individual who is not present in the United States at any time.*

* * *

[CCH Explanation at ¶ 975. Committee Reports at ¶ 13,720.]

Amendment Notes

Act Sec. 1601(i)(3)(B) amended Code Sec. 641(b) by adding at the end a new sentence to read as above.

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [generally effective for tax years beginning after December 31, 1996.—CCH.].

[¶ 5195] CODE SEC. *644*. TAXABLE YEAR OF TRUSTS.

* * *

[CCH Explanation at ¶ 275. Committee Reports at ¶ 10,415.]

Amendment Notes

Act Sec. 507(b)(1) amended subpart A of part I of subchapter J of chapter 1 by striking Code Sec. 644 and by redesignating Code Sec. 645 as Code Sec. 644. Prior to being stricken, Code Sec. 644 read as follows:

SEC. 644. SPECIAL RULE FOR GAIN ON PROPERTY TRANSFERRED TO TRUST AT LESS THAN FAIR MARKET VALUE.

(a) IMPOSITION OF TAX.—

(1) IN GENERAL.—If—

(A) a trust (or another trust to which the property is distributed) sells or exchanges property at a gain not more than 2 years after the date of the initial transfer of the property in trust by the transferor, and

(B) the fair market value of such property at the time of the initial transfer in trust by the transferor exceeds the adjusted basis of such property immediately after such transfer,

there is hereby imposed a tax determined in accordance with paragraph (2) on the includible gain recognized on such sale or exchange.

(2) AMOUNT OF TAX.—The amount of the tax imposed by paragraph (1) on any includible gain recognized on the sale or exchange of any property shall be equal to the sum of—

(A) the excess of—

(i) the tax which would have been imposed under this chapter for the taxable year of the transferor in which the sale or exchange of such property occurs had the amount of the includible gain recognized on such sale or exchange, reduced by any deductions properly allocable to such gain, been included in the gross income of the transferor for such taxable year, over

(ii) the tax actually imposed under this chapter for such taxable year of the transferor, plus

(B) if such sale or exchange occurs in a taxable year of the transferor which begins after the beginning of the taxable year of the trust in which such sale or exchange occurs, an amount equal to the amount determined under subparagraph (A) multiplied by the underpayment rate established under section 6621.

The determination of tax under clause (i) of subparagraph (A) shall be made by not taking into account any carryback, and by not taking into account any loss deduction to the extent that such loss or deduction may be carried by the transferor to any other taxable year.

(3) TAXABLE YEAR FOR WHICH TAX IMPOSED.—The tax imposed by paragraph (1) shall be imposed for the taxable year of the trust which begins with or within the taxable year of the transferor in which the sale or exchange occurs.

(4) TAX TO BE IN ADDITION TO OTHER TAXES.—The tax imposed by this subsection for any taxable year of the trust shall be in addition to any other tax imposed by this chapter for such taxable year.

(b) DEFINITION OF INCLUDIBLE GAIN.—For purposes of this section, the term "includible gain" means the lesser of—

(1) the gain recognized by the trust on the sale or exchange of any property, or

(2) the excess of the fair market value of such property at the time of the initial transfer in trust by the transferor over the adjusted basis of such property immediately after such transfer.

(c) CHARACTER OF INCLUDIBLE GAIN.—For purposes of subsection (a)—

(1) the character of the includible gain shall be determined as if the property had actually been sold or exchanged by the transferor, and any activities of the trust with respect to the sale or exchange of the property shall be deemed to be activities of the transferor, and

(2) the portion of the includible gain subject to the provisions of section 1245 and section 1250 shall be determined in accordance with regulations prescribed by the Secretary.

(d) SPECIAL RULES.—

(1) SHORT SALES.—If the trust sells the property referred to in subsection (a) in a short sale within the 2-year period referred to in such subsection, such 2-year period shall be extended to the date of the closing of such short sale.

(2) SUBSTITUTED BASIS PROPERTY.—For purposes of this section, in the case of any property held by the trust which has a basis determined in whole or in part by reference to the basis of any other property which was transferred to the trust—

(A) the initial transfer of such property in trust by the transferor shall be treated as having occurred on the date of the initial transfer in trust of such other property,

(B) subsections (a)(1)(B) and (b)(2) shall be applied by taking into account the fair market value and the adjusted basis of such other property, and

(C) the amount determined under subsection (b)(2) with respect to such other property shall be allocated (under regulations prescribed by the Secretary) among such other

property and all properties held by the trust which have a basis determined in whole or in part by reference to the basis of such other property.

(e) EXCEPTIONS.—Subsection (a) shall not apply to property—

(1) acquired by the trust from a decedent or which passed to a trust from a decedent (within the meaning of section 1014), or

(2) acquired by a pooled income fund (as defined in section 642(c)(5)), or

(3) acquired by a charitable remainder annuity trust (as defined in section 664(d)(1)) or a charitable remainder unitrust (as defined in sections 664(d)(2) and (3)), or

(4) if the sale or exchange of the property occurred after the death of the transferor.

(f) SPECIAL RULE FOR INSTALLMENT SALES.—If the trust reports income under section 453 on any sale or exchange to which subsection (a) applies, under regulations prescribed by the Secretary—

(1) subsection (a) (other than the 2-year requirement of paragraph (1)(A) thereof) shall be applied as if each installment were a separate sale or exchange of property to which such subsection applies, and

(2) the term "includible gain" shall not include any portion of an installment received by the trust after the death of the transferor.

The above amendment applies to sales or exchanges after the date of the enactment of this Act.

[¶ 5199] *CODE SEC. 646. CERTAIN REVOCABLE TRUSTS TREATED AS PART OF ESTATE.*

(a) GENERAL RULE.—For purposes of this subtitle, if both the executor (if any) of an estate and the trustee of a qualified revocable trust elect the treatment provided in this section, such trust shall be treated and taxed as part of such estate (and not as a separate trust) for all taxable years of the estate ending after the date of the decedent's death and before the applicable date.

(b) DEFINITIONS.—For purposes of subsection (a)—

(1) QUALIFIED REVOCABLE TRUST.—The term "qualified revocable trust" means any trust (or portion thereof) which was treated under section 676 as owned by the decedent of the estate referred to in subsection (a) by reason of a power in the grantor (determined without regard to section 672(e)).

(2) APPLICABLE DATE.—The term "applicable date" means—

(A) if no return of tax imposed by chapter 11 is required to be filed, the date which is 2 years after the date of the decedent's death, and

(B) if such a return is required to be filed, the date which is 6 months after the date of the final determination of the liability for tax imposed by chapter 11.

(c) ELECTION.—The election under subsection (a) shall be made not later than the time prescribed for filing the return of tax imposed by this chapter for the first taxable year of the estate (determined with regard to extensions) and, once made, shall be irrevocable.

* * *

[CCH Explanation at ¶ 261. Committee Reports at ¶ 12,635.]

Amendment Notes

Act Sec. 1305(a) amended subpart A of part I of subchapter J by adding at the end a new Code Sec. 646 to read as above.

The above amendment applies with respect to estates of decedents dying after the date of the enactment of this Act.

[¶ 5201] CODE SEC. 663. SPECIAL RULES APPLICABLE TO SECTIONS 661 AND 662.

* * *

(b) DISTRIBUTIONS IN FIRST SIXTY-FIVE DAYS OF TAXABLE YEAR.—

(1) GENERAL RULE.—If within the first 65 days of any taxable year of *an estate or* a trust, an amount is properly paid or credited, such amount shall be considered paid or credited on the last day of the preceding taxable year.

(2) LIMITATION.—Paragraph (1) shall apply with respect to any taxable year of *an estate or* a trust only if *the executor of such estate or the fiduciary of such trust (as the case may be)* elects, in such manner and at such time as the Secretary prescribes by regulations, to have paragraph (1) apply for such taxable year.

Amendment Notes

Act Sec. 1306(a) amended Code Sec. 663(b) by inserting "an estate or" before "a trust" each place it appears.

Act Sec. 1306(b) amended Code Sec. 663(b)(2) by striking "the fiduciary of such trust" and inserting "the executor of such estate or the fiduciary of such trust (as the case may be)".

The above amendments apply to tax years beginning after the date of the enactment of this Act.

(c) SEPARATE SHARES TREATED AS SEPARATE *ESTATES OR* TRUSTS.—For the sole purpose of determining the amount of distributable net income in the application of sections 661 and 662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts. *Rules similar to the rules of the preceding*

provisions of this subsection shall apply to treat substantially separate and independent shares of different beneficiaries in an estate having more than 1 beneficiary as separate estates. The existence of such substantially separate and independent shares and the manner of treatment as separate trusts *or estates*, including the application of subpart D, shall be determined in accordance with regulations prescribed by the Secretary.

[CCH Explanation at ¶ 264 and 267. Committee Reports at ¶ 12,640 and 12,645.]

Amendment Notes

Act Sec. 1307(a)(1)-(2) amended Code Sec. 663(c) by inserting before the last sentence a new sentence to read as above, and by inserting "or estates" after "trusts" in the last sentence.

Act Sec. 1307(b) amended Code Sec. 663(c) by inserting "ESTATES OR" before "TRUSTS" in the subsection heading.

The above amendments apply to estates of decedents dying after the date of the enactment of this Act.

[¶ 5203] CODE SEC. 664. CHARITABLE REMAINDER TRUSTS.

* * *

(d) DEFINITIONS.—

(1) CHARITABLE REMAINDER ANNUITY TRUST.—For purposes of this section, a charitable remainder annuity trust is a trust—

(A) from which a sum certain (which is not less than 5 percent *nor more than 50 percent* of the initial net fair market value of all property placed in trust) is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,

(B) from which no amount other than the payments described in subparagraph (A) *and other than qualified gratuitous transfers described in subparagraph (C)* may be paid to or for the use of any person other than an organization described in section 170(c),

(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c) or is to be retained by the trust for such a use *or, to the extent the remainder interest is in qualified employer securities (as defined in subsection (g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined by subsection (g))[, and]*

(D) the value (determined under section 7520) of such remainder interest is at least 10 percent of the initial net fair market value of all property placed in the trust.

(2) CHARITABLE REMAINDER UNITRUST.—For purposes of this section, a charitable remainder unitrust is a trust—

(A) from which a fixed percentage (which is not less than 5 percent *nor more than 50 percent*) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,

(B) from which no amount other than the payments described in subparagraph (A) *and other than qualified gratuitous transfers described in subparagraph (C)* may be paid to or for the use of any person other than an organization described in section 170(c),

(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c) or is to be retained by the trust for such a use *or, to the extent the remainder interest is in qualified employer securities (as defined in subsection (g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined by subsection (g))[, and]*

(D) with respect to each contribution of property to the trust, the value (determined under section 7520) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

* * *

(4) SEVERANCE OF CERTAIN ADDITIONAL CONTRIBUTIONS.—If—

(A) any contribution is made to a trust which before the contribution is a charitable remainder unitrust, and

(B) such contribution would (but for this paragraph) result in such trust ceasing to be a charitable unitrust by reason of paragraph (2)(D),

such contribution shall be treated as a transfer to a separate trust under regulations prescribed by the Secretary.

* * *

Amendment Notes

Act Sec. 1089(a)(1) amended Code Sec. 664(d)(1)(A) and (2)(A) by inserting "nor more than 50 percent" after "not less than 5 percent".

The above amendment applies to transfers in trust after June 18, 1997.

Act Sec. 1089(b)(1) amended Code Sec. 664(d)(1) by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C), and by adding at the end a new subparagraph (D) to read as above.

Act Sec. 1089(b)(2) amended Code Sec. 664(d)(2) by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C), and by adding at the end a new subparagraph (D) to read as above.

Act Sec. 1089(b)(4) amended Code Sec. 664(d) by adding at the end a new paragraph (4) to read as above.

The above amendments generally apply to transfers in trust after July 28, 1997. For a special rule, see Act Sec. 1089(b)(6)(B), below.

Act Sec. 1089(b)(6)(B) provides:

(B) SPECIAL RULE FOR CERTAIN DECEDENTS.—The amendments made by this subsection shall not apply to transfers in trust under the terms of a will (or other testamentary instrument) executed on or before July 28, 1997, if the decedent—

(i) dies before January 1, 1999, without having republished the will (or amended such instrument) by codicil or otherwise, or

(ii) was on July 28, 1997, under a mental disability to change the disposition of his property and did not regain his competence to dispose of such property before the date of his death.

Act Sec. 1530(a) amended Code Sec. 664(d)(1)(C) and (2)(C) by striking the period at the end thereof and inserting "or, to the extent the remainder interest is in qualified employer securities (as defined in subsection (g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined by subsection (g))."

Act Sec. 1530(c)(5) amended Code Sec. 664(d)(1)(B) and (2)(B) by inserting "and other than qualified gratuitous transfers described in subparagraph (C)" after "subparagraph (A)".

The above amendments apply to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

(g) QUALIFIED GRATUITOUS TRANSFER OF QUALIFIED EMPLOYER SECURITIES.—

(1) IN GENERAL.—For purposes of this section, the term "qualified gratuitous transfer" means a transfer of qualified employer securities to an employee stock ownership plan (as defined in section 4975(e)(7)) but only to the extent that—

(A) the securities transferred previously passed from a decedent dying before January 1, 1999, to a trust described in paragraph (1) or (2) of subsection (d),

(B) no deduction under section 404 is allowable with respect to such transfer,

(C) such plan contains the provisions required by paragraph (3),

(D) such plan treats such securities as being attributable to employer contributions but without regard to the limitations otherwise applicable to such contributions under section 404, and

(E) the employer whose employees are covered by the plan described in this paragraph files with the Secretary a verified written statement consenting to the application of sections 4978 and 4979A with respect to such employer.

(2) EXCEPTION.—The term "qualified gratuitous transfer" shall not include a transfer of qualified employer securities to an employee stock ownership plan unless—

(A) such plan was in existence on August 1, 1996,

(B) at the time of the transfer, the decedent and members of the decedent's family (within the meaning of section 2032A(e)(2)) own (directly or through the application of section 318(a)) no more than 10 percent of the value of the stock of the corporation referred to in paragraph (4), and

(C) immediately after the transfer, such plan owns (after the application of section 318(a)(4)) at least 60 percent of the value of the outstanding stock of the corporation.

(3) PLAN REQUIREMENTS.—A plan contains the provisions required by this paragraph if such plan provides that—

(A) the qualified employer securities so transferred are allocated to plan participants in a manner consistent with section 401(a)(4),

(B) plan participants are entitled to direct the plan as to the manner in which such securities which are entitled to vote and are allocated to the account of such participant are to be voted,

(C) an independent trustee votes the securities so transferred which are not allocated to plan participants,

(D) each participant who is entitled to a distribution from the plan has the rights described in subparagraphs (A) and (B) of section 409(h)(1),

(E) such securities are held in a suspense account under the plan to be allocated each year, up to the limitations under section 415(c), after first allocating all other annual additions for the limitation year, up to the limitations under sections 415(c) and (e), and

(F) on termination of the plan, all securities so transferred which are not allocated to plan participants as of such termination are to be transferred to, or for the use of, an organization described in section 170(c).

For purposes of the preceding sentence, the term "independent trustee" means any trustee who is not a member of the family (within the meaning of section 2032A(e)(2)) of the decedent or a 5-percent shareholder. A plan shall not fail to be treated as meeting the requirements of section 401(a) by reason of meeting the requirements of this subsection.

(4) QUALIFIED EMPLOYER SECURITIES.—For purposes of this section, the term "qualified employer securities" means employer securities (as defined in section 409(l)) which are issued by a domestic corporation—

(A) which has no outstanding stock which is readily tradable on an established securities market, and

(B) which has only 1 class of stock.

(5) TREATMENT OF SECURITIES ALLOCATED BY EMPLOYEE STOCK OWNERSHIP PLAN TO PERSONS RELATED TO DECEDENT OR 5-PERCENT SHAREHOLDERS.—

(A) IN GENERAL.—If any portion of the assets of the plan attributable to securities acquired by the plan in a qualified gratuitous transfer are allocated to the account of—

(i) any person who is related to the decedent (within the meaning of section 267(b)) or a member of the decedent's family (within the meaning of section 2032A(e)(2)), or

(ii) any person who, at the time of such allocation or at any time during the 1-year period ending on the date of the acquisition of qualified employer securities by the plan, is a 5-percent shareholder of the employer maintaining the plan, the plan shall be treated as having distributed (at the time of such allocation) to such person or shareholder the amount so allocated.

(B) 5-PERCENT SHAREHOLDER.—For purposes of subparagraph (A), the term "5-percent shareholder" means any person who owns (directly or through the application of section 318(a)) more than 5 percent of the outstanding stock of the corporation which issued such qualified employer securities or of any corporation which is a member of the same controlled group of corporations (within the meaning of section 409(l)(4)) as such corporation. For purposes of the preceding sentence, section 318(a) shall be applied without regard to the exception in paragraph (2)(B)(i) thereof.

(C) CROSS REFERENCE.—

For excise tax on allocations described in subparagraph (A), see section 4979A.

(6) TAX ON FAILURE TO TRANSFER UNALLOCATED SECURITIES TO CHARITY ON TERMINATION OF PLAN.—If the requirements of paragraph (3)(F) are not met with respect to any securities, there is hereby imposed a tax on the employer maintaining the plan in an amount equal to the sum of—

(A) the amount of the increase in the tax which would be imposed by chapter 11 if such securities were not transferred as described in paragraph (1), and

(B) interest on such amount at the underpayment rate under section 6621 (and compounded daily) from the due date for filing the return of the tax imposed by chapter 11.

[CCH Explanation at ¶ 281 and 284. Committee Reports at ¶ 11,555 and 13,435.]

Amendment Notes

Act Sec. 1530(b) amended Code Sec. 664 by adding at the end a new subsection (g) to read as above.

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

[¶ 5205] CODE SEC. 665. DEFINITIONS APPLICABLE TO SUBPART D.

* * *

(b) ACCUMULATION DISTRIBUTION.—For purposes of this subpart, *except as provided in subsection (c),* the term "accumulation distribution" means, for any taxable year of the trust, the amount by which—

(1) the amounts specified in paragraph (2) of section 661(a) for such taxable year, exceed

(2) distributable net income for such year reduced (but not below zero) by the amounts specified in paragraph (1) of section 661(a).

* * *

Amendment Notes

Act Sec. 507(a)(2) amended Code Sec. 665(b) by inserting "except as provided in subsection (c)," after "subpart,".

The above amendment applies to distributions in tax years beginning after the date of the enactment of this Act.

(c) EXCEPTION FOR ACCUMULATION DISTRIBUTIONS FROM CERTAIN DOMESTIC TRUSTS.—For purposes of this subpart—

(1) IN GENERAL.—In the case of a qualified trust, any distribution in any taxable year beginning after the date of the enactment of this subsection shall be computed without regard to any undistributed net income.

(2) QUALIFIED TRUST.—For purposes of this subsection, the term "qualified trust" means any trust other than—

(A) a foreign trust (or, except as provided in regulations, a domestic trust which at any time was a foreign trust), or

(B) a trust created before March 1, 1984, unless it is established that the trust would not be aggregated with other trusts under section 643(f) if such section applied to such trust.

Amendment Notes

Act Sec. 507(a)(1) amended Code Sec. 665 by inserting after subsection (b) a new subsection (c) to read as above.

The above amendment applies to distributions in tax years beginning after the date of the enactment of this Act.

(d) TAXES IMPOSED ON THE TRUST.—For purposes of this subpart—

(1) IN GENERAL.—The term "taxes imposed on the trust" means the amount of the taxes which are imposed for any taxable year of the trust under this chapter (without regard to this subpart or part IV of subchapter A) and which, under regulations prescribed by the Secretary, are properly allocable to the undistributed portions of distributable net income and gains in excess of losses from sales or exchanges of capital assets. The amount determined in the preceding sentence shall be reduced by any amount of such taxes deemed distributed under section 666(b) and (c) to any beneficiary.

* * *

[CCH Explanation at ¶ 275. Committee Reports at ¶ 10,415.]

Amendment Notes

Act Sec. 1604(g)(2) amended Code Sec. 665(d)(1) by striking "or 669(d) and (e)" before "to any beneficiary." in the last sentence.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5207] CODE SEC. 674. POWER TO CONTROL BENEFICIAL ENJOYMENT.

* * *

(b) EXCEPTIONS FOR CERTAIN POWERS.—Subsection (a) shall not apply to the following powers regardless of by whom held:

* * *

(4) POWER TO ALLOCATE AMONG CHARITABLE BENEFICIARIES.—A power to determine the beneficial enjoyment of the corpus or the income therefrom if the corpus or income is irrevocably payable for a purpose specified in section 170(c) (relating to definition of charitable contributions) *or to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined in section 664(g)(1)).*

* * *

[CCH Explanation at ¶ 284. Committee Reports at ¶ 13,435.]

Amendment Notes

Act Sec. 1530(c)(6) amended Code Sec. 674(b)(4) by inserting before the period "or to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined in section 664(g)(1))".

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

[¶ 5209] CODE SEC. 679. FOREIGN TRUSTS HAVING ONE OR MORE UNITED STATES BENEFICIARIES.

(a) TRANSFEROR TREATED AS OWNER.—

* * *

(3) CERTAIN OBLIGATIONS NOT TAKEN INTO ACCOUNT UNDER FAIR MARKET VALUE EXCEPTION.—

* * *

(C) PERSONS DESCRIBED.—The persons described in this subparagraph are—

(i) the trust,

(ii) any grantor, *owner,* or beneficiary of the trust, and

(iii) any person who is related (within the meaning of section 643(i)(2)(B)) to any grantor, *owner,* or beneficiary of the trust.

* * *

[CCH Explanation at ¶ 977. Committee Reports at ¶ 13,715.]

Amendment Notes

Act Sec. 1601(i)(2) amended Code Sec. 679(a)(3)(C)(ii)-(iii) by inserting ", owner," after "grantor".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for transfers of property after February 6, 1995.—CCH.].

[¶ 5211] *CODE SEC. 684. RECOGNITION OF GAIN ON CERTAIN TRANSFERS TO CERTAIN FOREIGN TRUSTS AND ESTATES.*

(a) IN GENERAL.—Except as provided in regulations, in the case of any transfer of property by a United States person to a foreign estate or trust, for purposes of this subtitle, such transfer shall be treated as a sale or exchange for an amount equal to the fair market value of the property transferred, and the transferor shall recognize as gain the excess of—

(1) the fair market value of the property so transferred, over

(2) the adjusted basis (for purposes of determining gain) of such property in the hands of the transferor.

(b) EXCEPTION.—Subsection (a) shall not apply to a transfer to a trust by a United States person to the extent that any person is treated as the owner of such trust under section 671.

(c) TREATMENT OF TRUSTS WHICH BECOME FOREIGN TRUSTS.—If a trust which is not a foreign trust becomes a foreign trust, such trust shall be treated for purposes of this section as having transferred, immediately before becoming a foreign trust, all of its assets to a foreign trust.

[CCH Explanation at ¶ 968 and 969. Committee Reports at ¶ 11,735.]

Amendment Notes

Act Sec. 1131(b) amended subpart F of part I of subchapter J of chapter 1 by adding at the end new section 684 to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5213] *CODE SEC. 685. TREATMENT OF FUNERAL TRUSTS.*

(a) IN GENERAL.—In the case of a qualified funeral trust—

(1) subparts B, C, D, and E shall not apply, and

(2) no deduction shall be allowed by section 642(b).

(b) QUALIFIED FUNERAL TRUST.—For purposes of this subsection, the term "qualified funeral trust" means any trust (other than a foreign trust) if—

(1) the trust arises as a result of a contract with a person engaged in the trade or business of providing funeral or burial services or property necessary to provide such services,

(2) the sole purpose of the trust is to hold, invest, and reinvest funds in the trust and to use such funds solely to make payments for such services or property for the benefit of the beneficiaries of the trust,

(3) the only beneficiaries of such trust are individuals with respect to whom such services or property are to be provided at their death under contracts described in paragraph (1),

(4) the only contributions to the trust are contributions by or for the benefit of such beneficiaries,

(5) the trustee elects the application of this subsection, and

(6) the trust would (but for the election described in paragraph (5)) be treated as owned under subpart E by the purchasers of the contracts described in paragraph (1).

(c) DOLLAR LIMITATION ON CONTRIBUTIONS.—

(1) IN GENERAL.—The term "qualified funeral trust" shall not include any trust which accepts aggregate contributions by or for the benefit of an individual in excess of $7,000.

(2) RELATED TRUSTS.—For purposes of paragraph (1), all trusts having trustees which are related persons shall be treated as 1 trust. For purposes of the preceding sentence, persons are related if—

(A) the relationship between such persons is described in section 267 or 707(b),

(B) such persons are treated as a single employer under subsection (a) or (b) of section 52, or

(C) the Secretary determines that treating such persons as related is necessary to prevent avoidance of the purposes of this section.

(3) INFLATION ADJUSTMENT.—In the case of any contract referred to in subsection (b)(1) which is entered into during any calendar year after 1998, the dollar amount referred to paragraph (1) shall be increased by an amount equal to—

(A) such dollar amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year, by substituting "calendar year 1997" for "calendar year 1992" in subparagraph (B) thereof.

If any dollar amount after being increased under the preceding sentence is not a multiple of $100, such dollar amount shall be rounded to the nearest multiple of $100.

(d) APPLICATION OF RATE SCHEDULE.—Section 1(e) shall be applied to each qualified funeral trust by treating each beneficiary's interest in each such trust as a separate trust.

(e) TREATMENT OF AMOUNTS REFUNDED TO PURCHASER ON CANCELLATION.—No gain or loss shall be recognized to a purchaser of a contract described in subsection (b)(1) by reason of any payment from such trust to such purchaser by reason of cancellation of such contract. If any payment referred to in the preceding sentence consists of property other than money, the basis of such property in the hands of such purchaser shall be the same as the trust's basis in such property immediately before the payment.

(f) SIMPLIFIED REPORTING.—The Secretary may prescribe rules for simplified reporting of all trusts having a single trustee.

[CCH Explanation at ¶ 286. Committee Reports at ¶ 12,655.]

Amendment Notes

Act Sec. 1309(a) amended subpart F of part I of subchapter J of chapter 1 by adding at the end a new Code Sec. 685 to read as above.

The above amendment applies to tax years ending after the date of the enactment of this Act.

[¶ 5215] CODE SEC. 691. RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS.

* * *

(c) DEDUCTION FOR ESTATE TAX.—

(1) ALLOWANCE OF DEDUCTION.—

* * *

(C) *[Stricken.]*

* * *

[CCH Explanation at ¶ 714. Committee Reports at ¶ 11,465.]

Amendment Notes

Act Sec. 1073(b)(1) amended Code Sec. 691(c)(1) by striking subparagraph (C). Prior to being stricken, Code Sec. 691(c)(1)(C) read as follows:

(C) EXCESS RETIREMENT ACCUMULATION TAX.—For purposes of this subsection, no deduction shall be allowed for the portion of the estate tax attributable to the increase in such tax under section 4980A(d).

The above amendment applies to estates of decedents dying after December 31, 1996.

[¶ 5217] CODE SEC. 704. PARTNER'S DISTRIBUTIVE SHARE.

* * *

(c) CONTRIBUTED PROPERTY.—

(1) IN GENERAL.—Under regulations prescribed by the Secretary—

* * *

(B) if any property so contributed is distributed (directly or indirectly) by the partnership (other than to the contributing partner) within *7 years* of being contributed—

* * *

[CCH Explanation at ¶ 407. Committee Reports at ¶ 11,425.]

Amendment Notes

Act Sec. 1063(a) amended Code Sec. 704(c)(1)(B) by striking "5 years" and inserting "7 years".

The above amendment applies to property contributed to a partnership after June 8, 1997. For a special rule, see Act Sec. 1063(b)(2), below.

Act Sec. 1063(b)(2) provides:

(2) BINDING CONTRACTS.—The amendment made by subsection (a) shall not apply to any property contributed pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such contribution if such contract provides for the contribution of a fixed amount of property.

[¶ 5219] CODE SEC. 706. TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

* * *

(b) TAXABLE YEAR.—

* * *

(5) APPLICATION WITH OTHER SECTIONS.—Except as provided in regulations, for purposes of determining the taxable year to which a partnership is required to change by reason of this subsection, changes in taxable years of other persons required by this subsection, section 441(i), section 584(h), *section 644*, or section 1378(a) shall be taken into account.

Amendment Notes

Act Sec. 507(b)(2) amended Code Sec. 706(b)(5) by striking "section 645" and inserting "section 644".

The above amendment applies to sales or exchanges after the date of the enactment of this Act.

(c) CLOSING OF PARTNERSHIP YEAR.—

* * *

(2) *TREATMENT OF DISPOSITIONS.*—

(A) DISPOSITION OF ENTIRE INTEREST.—The taxable year of a partnership shall close with respect to a partner whose entire interest in the partnership terminates (whether by reason of death, liquidation, or otherwise).

* * *

[CCH Explanation at ¶ 275 and 465. Committee Reports at ¶ 10,415 and 12,415.]

Amendment Notes

Act Sec. 1246(a) amended Code Sec. 706(c)(2)(A) to read as above. Prior to amendment, Code Sec. 706(c)(2)(A) read as follows:

(A) DISPOSITION OF ENTIRE INTEREST.—The taxable year of a partnership shall close—

(i) with respect to a partner who sells or exchanges his entire interest in a partnership, and

(ii) with respect to a partner whose interest is liquidated, except that the taxable year of a partnership with respect to a partner who dies shall not close prior to the end of the partnership's taxable year.

Act Sec. 1246(b) amended the heading of Code Sec. 706(c)(2) to read as above. Prior to amendment, the paragraph heading for Code Sec. 706(c)(2) read as follows:

(2) PARTNER WHO RETIRES OR SELLS INTEREST IN PARTNERSHIP.—

The above amendments apply to partnership tax years beginning after December 31, 1997.

[¶ 5221] CODE SEC. 721. NONRECOGNITION OF GAIN OR LOSS ON CONTRIBUTION.

* * *

(c) REGULATIONS RELATING TO CERTAIN TRANSFERS TO PARTNERSHIPS.—The Secretary may provide by regulations that subsection (a) shall not apply to gain realized on the transfer of property to a partnership if such gain, when recognized, will be includible in the gross income of a person other than a United States person.

Amendment Notes

Act Sec. 1131(b)[(c)](3) amended Code Sec. 721 by adding at the end a new subsection (c) to read as above.

The above amendment is effective on the date of the enactment of this Act.

(d) TRANSFERS OF INTANGIBLES.—

For regulatory authority to treat intangibles transferred to a partnership as sold, see section 367(d)(3).

* * *

[CCH Explanation at ¶ 968 and 969. Committee Reports at ¶ 11,735.]

Amendment Notes

Act Sec. 1131(b)[(c)](5)(B) amended Code Sec. 721 by adding at the end a new subsection (d) to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5223] CODE SEC. 724. CHARACTER OF GAIN OR LOSS ON CONTRIBUTED UNREALIZED RECEIVABLES, INVENTORY ITEMS, AND CAPITAL LOSS PROPERTY.

* * *

(d) DEFINITIONS.—For purposes of this section—

* * *

(2) INVENTORY ITEM.—The term "inventory item" has the meaning given such term by *section 751(d)* (determined by treating any reference to the partnership as referring to the partner and by applying section 1231 without regard to any holding period therein provided).

* * *

[CCH Explanation at ¶ 410. Committee Reports at ¶ 11,420.]

Amendment Notes

Act Sec. 1062(b)(3) amended Code Sec. 724(d)(2) by striking "section 751(d)(2)" and inserting "section 751(d)".

The above amendment applies to sales, exchanges, and distributions after the date of the enactment of this Act. For a special rule, see Act Sec. 1062(c)(2), below.

Act Sec. 1062(c)(2) provides:

(2) BINDING CONTRACTS.—The amendments made by this section shall not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such sale or exchange.

[¶ 5225] CODE SEC. 731. EXTENT OF RECOGNITION OF GAIN OR LOSS ON DISTRIBUTION.

(a) PARTNERS.—In the case of a distribution by a partnership to a partner—

(1) gain shall not be recognized to such partner, except to the extent that any money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution, and

(2) loss shall not be recognized to such partner, except that upon a distribution in liquidation of a partner's interest in a partnership where no property other than that described in subparagraph (A) or (B) is distributed to such partner, loss shall be recognized to the extent of the excess of the adjusted basis of such partner's interest in the partnership over the sum of—

(A) any money distributed, and

(B) the basis to the distributee, as determined under section 732, of any unrealized receivables (as defined in section 751(c)) and inventory (as defined in *section 751(d)*).

* * *

Amendment Notes

Act Sec. 1062(b)(3) amended Code Sec. 731(a)(2)(B) by striking "section 751(d)(2)" and inserting "section 751(d)".

The above amendment applies to sales, exchanges, and distributions after the date of the enactment of this Act. For a special rule, see Act Sec. 1062(c)(2), below.

Act Sec. 1062(c)(2) provides:

(2) BINDING CONTRACTS.—The amendments made by this section shall not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such sale or exchange.

(c) TREATMENT OF MARKETABLE SECURITIES.—

* * *

(6) CHARACTER OF GAIN RECOGNIZED.—In the case of a distribution of a marketable security which is an unrealized receivable (as defined in section 751(c)) or an inventory item (as defined in section 751(c)) or an inventory item (as defined in *section 751(d)*), any gain recognized under this subsection shall be treated as ordinary income to the extent of any increase in the basis of such security attributable to the gain described in paragraph (4)(A)(ii).

* * *

[CCH Explanation at ¶ 410. Committee Reports at ¶ 11,420.]

Amendment Notes

Act Sec. 1062(b)(3) amended Code Sec. 731(c)(6) by striking "section 751(d)(2)" and inserting "section 751(d)".

The above amendment applies to sales, exchanges, and distributions after the date of the enactment of this Act. For a special rule, see Act Sec. 1062(c)(2), below.

Act Sec. 1062(c)(2) provides:

(2) BINDING CONTRACTS.—The amendments made by this section shall not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such sale or exchange.

[¶ 5227] CODE SEC. 732. BASIS OF DISTRIBUTED PROPERTY OTHER THAN MONEY.

* * *

(c) ALLOCATION OF BASIS.—

(1) IN GENERAL.—The basis of distributed properties to which subsection (a)(2) or (b) is applicable shall be allocated—

(A)(i) first to any unrealized receivables (as defined in section 751(c)) and inventory items (as defined in section 751(d)) in an amount equal to the adjusted basis of each such property to the partnership, and

(ii) if the basis to be allocated is less than the sum of the adjusted bases of such properties to the partnership, then, to the extent any decrease is required in order to have the adjusted bases of such properties equal the basis to be allocated, in the manner provided in paragraph (3), and

(B) to the extent of any basis remaining after the allocation under subparagraph (A), to other distributed properties—

(i) first by assigning to each such other property such other property's adjusted basis to the partnership, and

(ii) then, to the extent any increase or decrease in basis is required in order to have the adjusted bases of such other distributed properties equal such remaining basis, in the manner provided in paragraph (2) or (3), whichever is appropriate.

(2) METHOD OF ALLOCATING INCREASE.—Any increase required under paragraph (1)(B) shall be allocated among the properties—

(A) first to properties with unrealized appreciation in proportion to their respective amounts of unrealized appreciation before such increase (but only to the extent of each property's unrealized appreciation), and

(B) then, to the extent such increase is not allocated under subparagraph (A), in proportion to their respective fair market values.

(3) METHOD OF ALLOCATING DECREASE.—Any decrease required under paragraph (1)(A) or (1)(B) shall be allocated—

(A) first to properties with unrealized depreciation in proportion to their respective amounts of unrealized depreciation before such decrease (but only to the extent of each property's unrealized depreciation), and

(B) then, to the extent such decrease is not allocated under subparagraph (A), in proportion to their respective adjusted bases (as adjusted under subparagraph (A)).

* * *

[CCH Explanation at ¶ 403 and 410. Committee Reports at ¶ 11,415 and 11,420.]

Amendment Notes

Act Sec. 1061(a) amended Code Sec. 732(c) to read as above. Prior to amendment, Code Sec. 732(c) read as follows:

(c) ALLOCATION OF BASIS.—The basis of distributed properties to which subsection (a)(2) or subsection (b) is applicable shall be allocated—

(1) first to any unrealized receivables (as defined in section 751(c)) and inventory items (as defined in section 751(d)(2)) in an amount equal to the adjusted basis of each such property to the partnership (or if the basis to be allocated is less than the sum of the adjusted bases of such properties to the partnership, in proportion to such bases), and

(2) to the extent of any remaining basis, to any other distributed properties in proportion to their adjusted bases to the partnership.

The above amendment applies to distributions after the date of the enactment of this Act.

Act Sec. 1062(b)(3) amended Code Sec. 732(c)(1)(A), as amended, by striking "section 751(d)(2)" and inserting "section 751(d)".

The above amendment generally applies to sales, exchanges, and distributions after the date of the enactment of this Act. For a special rule, see Act Sec. 1062(c)(2), below.

Act Sec. 1062(c)(2) provides:

(2) BINDING CONTRACTS.—The amendments made by this section shall not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such sale or exchange.

[¶ 5229] CODE SEC. 735. CHARACTER OF GAIN OR LOSS ON DISPOSITION OF DISTRIBUTED PROPERTY.

(a) SALE OR EXCHANGE OF CERTAIN DISTRIBUTED PROPERTY.—

* * *

(2) INVENTORY ITEMS.—Gain or loss on the sale or exchange by a distributee partner of inventory items (as defined in *section 751(d)*) distributed by a partnership shall, if sold or exchanged within 5

years from the date of the distribution, be considered as ordinary income or as ordinary loss, as the case may be.

* * *

Amendment Notes

Act Sec. 1062(b)(3) amended Code Sec. 735(a)(2) by striking "section 751(d)(2)" and inserting "section 751(d)".

The above amendment generally applies to sales, exchanges, and distributions after the date of the enactment of this Act. For a special rule, see Act Sec. 1062(c)(2), below.

Act Sec. 1062(c)(2) provides:

(2) BINDING CONTRACTS.—The amendments made by this section shall not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such sale or exchange.

(c) SPECIAL RULES.—

(1) WAIVER OF HOLDING PERIODS CONTAINED IN section 1231.—For purposes of this section, *section 751(d)* (defining inventory item) shall be applied without regard to any holding period in section 1231(b).

* * *

[CCH Explanation at ¶ 410. Committee Reports at ¶ 11,420.]

Amendment Notes

Act Sec. 1062(b)(3) amended Code Sec. 735(c)(1) by striking "section 751(d)(2)" and inserting "section 751(d)".

The above amendment generally applies to sales, exchanges, and distributions after the date of the enactment of this Act. For a special rule, see Act Sec. 1062(c)(2), below.

Act Sec. 1062(c)(2) provides:

(2) BINDING CONTRACTS.—The amendments made by this section shall not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such sale or exchange.

[¶ 5230] CODE SEC. 737. RECOGNITION OF PRECONTRIBUTION GAIN IN CASE OF CERTAIN DISTRIBUTIONS TO CONTRIBUTING PARTNER.

* * *

(b) NET PRECONTRIBUTION GAIN.—For purposes of this section, the term "net precontribution gain" means the net gain (if any) which would have been recognized by the distributee partner under section 704(c)(1)(B) if all property which—

(1) had been contributed to the partnership by the distributee partner within *7 years* of the distribution, and

(2) is held by such partnership immediately before the distribution,

had been distributed by such partnership to another partner.

* * *

[CCH Explanation at ¶ 407. Committee Reports at ¶ 11,425.]

Amendment Notes

Act Sec. 1063(a) amended Code Sec. 737(b)(1) by striking "5 years" and inserting "7 years".

The above amendment generally applies to property contributed to a partnership after June 8, 1997. For a special rule, see Act Sec. 1063(b)(2), below.

Act Sec. 1063(b)(2) provides:

(2) BINDING CONTRACTS.—The amendment made by subsection (a) shall not apply to any property contributed pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such contribution if such contract provides for the contribution of a fixed amount of property.

[¶ 5231] CODE SEC. 751. UNREALIZED RECEIVABLES AND INVENTORY ITEMS.

(a) SALE OR EXCHANGE OF INTEREST IN PARTNERSHIP.—The amount of any money, or the fair market value of any property, received by a transferor partner in exchange for all or a part of his interest in the partnership attributable to—

(1) unrealized receivables of the partnership, or

(2) inventory items of the partnership,

shall be considered as an amount realized from the sale or exchange of property other than a capital asset.

Amendment Notes

Act Sec. 1062(a) amended Code Sec. 751(a)(2) to read as above. Prior to amendment, Code Sec. 751(a)(2) read as follows:

(2) inventory items of the partnership which have appreciated substantially in value,

The above amendment generally applies to sales, exchanges, and distributions after the date of the enactment of this Act. For a special rule, see Act Sec. 1062(c)(2), below.

Act Sec. 1062(c)(2) provides:

(2) BINDING CONTRACTS.—The amendments made by this section shall not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such sale or exchange.

(b) CERTAIN DISTRIBUTIONS TREATED AS SALES OR EXCHANGES.—

(1) GENERAL RULE.—To the extent a partner receives in a distribution—

(A) partnership property which is—

(i) unrealized receivables, or

(ii) inventory items which have appreciated substantially in value,

in exchange for all or a part of his interest in other partnership property (including money), or

(B) partnership property (including money) other than property described in subparagraph (A)(i) or (ii) in exchange for all or a part of his interest in partnership property described in subparagraph (A)(i) or (ii),

such transactions shall, under regulations prescribed by the Secretary, be considered as a sale or exchange of such property between the distributee and the partnership (as constituted after the distribution).

* * *

(3) SUBSTANTIAL APPRECIATION.—For purposes of paragraph (1)—

(A) IN GENERAL.—Inventory items of the partnership shall be considered to have appreciated substantially in value if their fair market value exceeds 120 percent of the adjusted basis to the partnership of such property.

(B) CERTAIN PROPERTY EXCLUDED.—For purposes of subparagraph (A), there shall be excluded any inventory property if a principal purpose for acquiring such property was to avoid the provisions of this subsection relating to inventory items.

* * *

Amendment Notes

Act Sec. 1062(b)(1)(A) amended Code Sec. 751(b)(1) by striking subparagraphs (A) and (B) and inserting new subparagraphs (A) and (B) to read as above. Prior to being stricken, Code Sec. 751(b)(1)(A)-(B) read as follows:

(A) partnership property described in subsection (a)(1) or (2) in exchange for all or a part of his interest in other partnership property (including money), or

(B) partnership property (including money) other than property described in subsection (a) (1) or (2) in exchange for all or a part of his interest in partnership property described in subsection (a) (1) or (2),

Act Sec. 1062(b)(1)(B) amended Code Sec. 751(b) by adding at the end a new paragraph (3) to read as above.

The above amendments generally apply to sales, exchanges, and distributions after the date of the enactment of this Act. For a special rule, see Act Sec. 1062(c)(2), below.

Act Sec. 1062(c)(2) provides:

(2) BINDING CONTRACTS.—The amendments made by this section shall not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such sale or exchange.

(d) INVENTORY ITEMS.—For purposes of this subchapter, the term "inventory items" means—

(1) property of the partnership of the kind described in section 1221(1),

(2) any other property of the partnership which, on sale or exchange by the partnership, would be considered property other than a capital asset and other than property described in section 1231,

(3) any other property of the partnership which, if sold or exchanged by the partnership, would result in a gain taxable under subsection (a) of section 1246 (relating to gain on foreign investment company stock), and

(4) any other property held by the partnership which, if held by the selling or distributee partner, would be considered property of the type described in paragraph (1), (2), or (3).

* * *

[CCH Explanation at ¶ 410. Committee Reports at ¶ 11,420.]

Amendment Notes

Act Sec. 1062(b)(2) amended Code Sec. 751(d) to read as above. Prior to amendment, Code Sec. 751(d) read as follows:

(d) INVENTORY ITEMS WHICH HAVE APPRECIATED SUBSTANTIALLY IN VALUE.—

(1) SUBSTANTIAL APPRECIATION.—

(A) IN GENERAL.—Inventory items of the partnership shall be considered to have appreciated substantially in value if their fair market value exceeds 120 percent of the adjusted basis to the partnership of such property.

(B) CERTAIN PROPERTY EXCLUDED.—For purposes of subparagraph (A), there shall be excluded any inventory property if a principal purpose for acquiring such property was to avoid the provisions of this section relating to inventory items.

(2) INVENTORY ITEMS.—For purposes of this subchapter the term "inventory items" means—

(A) property of the partnership of the kind described in section 1221(1),

(B) any other property of the partnership which, on sale or exchange by the partnership, would be considered property other than a capital asset and other than property described in section 1231,

(C) any other property of the partnership which, if sold or exchanged by the partnership, would result in a gain taxable under subsection (a) of section 1246 (relating to gain on foreign investment company stock), and

(D) any other property held by the partnership which, if held by the selling or distributee partner, would be considered property of the type described in subparagraph (A), (B), or (C).

The above amendment generally applies to sales, exchanges, and distributions after the date of the enactment of this Act. For a special rule, see Act Sec. 1062(c)(2), below.

Act Sec. 1062(c)(2) provides:

(2) BINDING CONTRACTS.—The amendments made by this section shall not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such sale or exchange.

[¶ 5233] *CODE SEC. 771. APPLICATION OF SUBCHAPTER TO ELECTING LARGE PARTNERSHIPS.*

The preceding provisions of this subchapter to the extent inconsistent with the provisions of this part shall not apply to an electing large partnership and its partners.

[CCH Explanation at ¶ 412-420. Committee Reports at ¶ 12,215.]

Amendment Notes

Act Sec. 1221(a) amended subchapter K by adding at the end a new part IV (Code Secs. 771-777) to read as above.

The above amendment applies to partnership tax years beginning after December 31, 1997.

[¶ 5235] *CODE SEC. 772. SIMPLIFIED FLOW-THROUGH.*

(a) GENERAL RULE.—In determining the income tax of a partner of an electing large partnership, such partner shall take into account separately such partner's distributive share of the partnership's—

(1) taxable income or loss from passive loss limitation activities,

(2) taxable income or loss from other activities,

(3) net capital gain (or net capital loss)—

(A) to the extent allocable to passive loss limitation activities, and

(B) to the extent allocable to other activities,

(4) tax-exempt interest,

(5) applicable net AMT adjustment separately computed for—

(A) passive loss limitation activities, and

(B) other activities,

(6) general credits,

(7) low-income housing credit determined under section 42,

(8) rehabilitation credit determined under section 47,

(9) foreign income taxes,

(10) the credit allowable under section 29, and

(11) other items to the extent that the Secretary determines that the separate treatment of such items is appropriate.

(b) SEPARATE COMPUTATIONS.—In determining the amounts required under subsection (a) to be separately taken into account by any partner, this section and section 773 shall be applied separately with respect to such partner by taking into account such partner's distributive share of the items of income, gain, loss, deduction, or credit of the partnership.

(c) TREATMENT AT PARTNER LEVEL.—

(1) IN GENERAL.—Except as provided in this subsection, rules similar to the rules of section 702(b) shall apply to any partner's distributive share of the amounts referred to in subsection (a).

(2) INCOME OR LOSS FROM PASSIVE LOSS LIMITATION ACTIVITIES.—For purposes of this chapter, any partner's distributive share of any income or loss described in subsection (a)(1) shall be treated as an item of income or loss (as the case may be) from the conduct of a trade or business which is a single passive activity (as defined in section 469). A similar rule shall apply to a partner's distributive share of amounts referred to in paragraphs (3)(A) and (5)(A) of subsection (a).

(3) INCOME OR LOSS FROM OTHER ACTIVITIES.—

(A) IN GENERAL.—For purposes of this chapter, any partner's distributive share of any income or loss described in subsection (a)(2) shall be treated as an item of income or expense (as the case may be) with respect to property held for investment.

(B) Deductions for loss not subject to section 67.—The deduction under section 212 for any loss described in subparagraph (A) shall not be treated as a miscellaneous itemized deduction for purposes of section 67.

(4) Treatment of net capital gain or loss.—For purposes of this chapter, any partner's distributive share of any gain or loss described in subsection (a)(3) shall be treated as a long-term capital gain or loss, as the case may be.

(5) Minimum tax treatment.—In determining the alternative minimum taxable income of any partner, such partner's distributive share of any applicable net AMT adjustment shall be taken into account in lieu of making the separate adjustments provided in sections 56, 57, and 58 with respect to the items of the partnership. Except as provided in regulations, the applicable net AMT adjustment shall be treated, for purposes of section 53, as an adjustment or item of tax preference not specified in section 53(d)(1)(B)(ii).

(6) General credits.—A partner's distributive share of the amount referred to in paragraph (6) of subsection (a) shall be taken into account as a current year business credit.

(d) Operating Rules.—For purposes of this section—

(1) Passive loss limitation activity.—The term "passive loss limitation activity" means—

(A) any activity which involves the conduct of a trade or business, and

(B) any rental activity.

For purposes of the preceding sentence, the term "trade or business" includes any activity treated as a trade or business under paragraph (5) or (6) of section 469(c).

(2) Tax-exempt interest.—The term "tax-exempt interest" means interest excludable from gross income under section 103.

(3) Applicable net AMT adjustment.—

(A) In general.—The applicable net AMT adjustment is—

(i) with respect to taxpayers other than corporations, the net adjustment determined by using the adjustments applicable to individuals, and

(ii) with respect to corporations, the net adjustment determined by using the adjustments applicable to corporations.

(B) Net adjustment.—The term "net adjustment" means the net adjustment in the items attributable to passive loss activities or other activities (as the case may be) which would result if such items were determined with the adjustments of sections 56, 57, and 58.

(4) Treatment of certain separately stated items.—

(A) Exclusion for certain purposes.—In determining the amounts referred to in paragraphs (1) and (2) of subsection (a), any net capital gain or net capital loss (as the case may be), and any item referred to in subsection (a)(11), shall be excluded.

(B) Allocation rules.—The net capital gain shall be treated—

(i) as allocable to passive loss limitation activities to the extent the net capital gain does not exceed the net capital gain determined by only taking into account gains and losses from sales and exchanges of property used in connection with such activities, and

(ii) as allocable to other activities to the extent such gain exceeds the amount allocated under clause (i).

A similar rule shall apply for purposes of allocating any net capital loss.

(C) Net capital loss.—The term "net capital loss" means the excess of the losses from sales or exchanges of capital assets over the gains from sales or exchange of capital assets.

(5) General credits.—The term "general credits" means any credit other than the low-income housing credit, the rehabilitation credit, the foreign tax credit, and the credit allowable under section 29.

(6) Foreign income taxes.—The term "foreign income taxes" means taxes described in section 901 which are paid or accrued to foreign countries and to possessions of the United States.

(e) Special Rule for Unrelated Business Tax.—In the case of a partner which is an organization subject to tax under section 511, such partner's distributive share of any items shall be taken into account separately to the extent necessary to comply with the provisions of section 512(c)(1).

(f) Special Rules for Applying Passive Loss Limitations.—If any person holds an interest in an electing large partnership other than as a limited partner—

(1) paragraph (2) of subsection (c) shall not apply to such partner, and

(2) such partner's distributive share of the partnership items allocable to passive loss limitation activities shall be taken into account separately to the extent necessary to comply with the provisions of section 469.

The preceding sentence shall not apply to any items allocable to an interest held as a limited partner.

[CCH Explanation at ¶ 412-420. Committee Reports at ¶ 12,215.]

Amendment Notes

Act Sec. 1221(a) added Code Sec. 772 to read as above.

The above amendment applies to partnership tax years beginning after December 31, 1997.

[¶ 5237] *CODE SEC. 773. COMPUTATIONS AT PARTNERSHIP LEVEL.*

(a) General Rule.—

(1) Taxable income.—The taxable income of an electing large partnership shall be computed in the same manner as in the case of an individual except that—

(A) the items described in section 772(a) shall be separately stated, and

(B) the modifications of subsection (b) shall apply.

(2) Elections.—All elections affecting the computation of the taxable income of an electing large partnership or the computation of any credit of an electing large partnership shall be made by the partnership; except that the election under section 901, and any election under section 108, shall be made by each partner separately.

(3) Limitations, etc.—

(A) In general.—Except as provided in subparagraph (B), all limitations and other provisions affecting the computation of the taxable income of an electing large partnership or the computation of any credit of an electing large partnership shall be applied at the partnership level (and not at the partner level).

(B) Certain limitations applied at partner level.—The following provisions shall be applied at the partner level (and not at the partnership level):

(i) Section 68 (relating to overall limitation on itemized deductions).

(ii) Sections 49 and 465 (relating to at risk limitations).

(iii) Section 469 (relating to limitation on passive activity losses and credits).

(iv) Any other provision specified in regulations.

(4) Coordination with other provisions.—Paragraphs (2) and (3) shall apply notwithstanding any other provision of this chapter other than this part.

(b) Modifications To Determination of Taxable Income.—In determining the taxable income of an electing large partnership—

(1) Certain deductions not allowed.—The following deductions shall not be allowed:

(A) The deduction for personal exemptions provided in section 151.

(B) The net operating loss deduction provided in section 172.

(C) The additional itemized deductions for individuals provided in part VII of subchapter B (other than section 212 thereof).

(2) Charitable deductions.—In determining the amount allowable under section 170, the limitation of section 170(b)(2) shall apply.

(3) Coordination with section 67.—In lieu of applying section 67, 70 percent of the amount of the miscellaneous itemized deductions shall be disallowed.

(c) Special Rules for Income From Discharge of Indebtedness.—If an electing large partnership has income from the discharge of any indebtedness—

(1) such income shall be excluded in determining the amounts referred to in section 772(a), and

(2) in determining the income tax of any partner of such partnership—

(A) such income shall be treated as an item required to be separately taken into account under section 772(a), and

(B) the provisions of section 108 shall be applied without regard to this part.

[CCH Explanation at ¶ 412-420. Committee Reports at ¶ 12,215.]

Amendment Notes

Act Sec. 1221(a) added Code Sec. 773 to read as above.

The above amendment applies to partnership tax years beginning after December 31, 1997.

[¶ 5239] *CODE SEC. 774. OTHER MODIFICATIONS.*

(a) Treatment of Certain Optional Adjustments, Etc.—In the case of an electing large partnership—

(1) computations under section 773 shall be made without regard to any adjustment under section 743(b) or 108(b), but

(2) a partner's distributive share of any amount referred to in section 772(a) shall be appropriately adjusted to take into account any adjustment under section 743(b) or 108(b) with respect to such partner.

(b) Credit Recapture Determined at Partnership Level.—

(1) In general.—In the case of an electing large partnership—

(A) any credit recapture shall be taken into account by the partnership, and

(B) the amount of such recapture shall be determined as if the credit with respect to which the recapture is made had been fully utilized to reduce tax.

(2) Method of taking recapture into account.—An electing large partnership shall take into account a credit recapture by reducing the amount of the appropriate current year credit to the extent thereof, and if such recapture exceeds the amount of such current year credit, the partnership shall be liable to pay such excess.

(3) Dispositions not to trigger recapture.—No credit recapture shall be required by reason of any transfer of an interest in an electing large partnership.

(4) Credit recapture.—For purposes of this subsection, the term "credit recapture" means any increase in tax under section 42(j) or 50(a).

(c) Partnership Not Terminated By Reason of Change in Ownership.—Subparagraph (B) of section 708(b)(1) shall not apply to an electing large partnership.

(d) Partnership Entitled to Certain Credits.—The following shall be allowed to an electing large partnership and shall not be taken into account by the partners of such partnership:

(1) The credit provided by section 34.

(2) Any credit or refund under section 852(b)(3)(D).

(e) Treatment of REMIC Residuals.—For purposes of applying section 860E(e)(6) to any electing large partnership—

(1) all interests in such partnership shall be treated as held by disqualified organizations,

(2) in lieu of applying subparagraph (C) of section 860E(e)(6), the amount subject to tax under section 860E(e)(6) shall be excluded from the gross income of such partnership, and

(3) subparagraph (D) of section 860E(e)(6) shall not apply.

(f) Special Rules for Applying Certain Installment Sale Rules.—In the case of an electing large partnership—

(1) the provisions of sections 453(l)(3) and 453A shall be applied at the partnership level, and

(2) in determining the amount of interest payable under such sections, such partnership shall be treated as subject to tax under this chapter at the highest rate of tax in effect under section 1 or 11.

[CCH Explanation at ¶ 412-420. Committee Reports at ¶ 12,215.]

Amendment Notes

Act Sec. 1221(a) added Code Sec. 774 to read as above.

The above amendment applies to partnership tax years beginning after December 31, 1997.

[¶ 5241] *CODE SEC. 775. ELECTING LARGE PARTNERSHIP DEFINED.*

(a) General Rule.—For purposes of this part—

(1) In general.—The term "electing large partnership" means, with respect to any partnership taxable year, any partnership if—

(A) the number of persons who were partners in such partnership in the preceding partnership taxable year equaled or exceeded 100, and

(B) such partnership elects the application of this part.

To the extent provided in regulations, a partnership shall cease to be treated as an electing large partnership for any partnership taxable year if in such taxable year fewer than 100 persons were partners in such partnership.

(2) ELECTION.—The election under this subsection shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

(b) SPECIAL RULES FOR CERTAIN SERVICE PARTNERSHIPS.—

(1) CERTAIN PARTNERS NOT COUNTED.—For purposes of this section, the term "partner" does not include any individual performing substantial services in connection with the activities of the partnership and holding an interest in such partnership, or an individual who formerly performed substantial services in connection with such activities and who held an interest in such partnership at the time the individual performed such services.

(2) EXCLUSION.—For purposes of this part, an election under subsection (a) shall not be effective with respect to any partnership if substantially all the partners of such partnership—

(A) are individuals performing substantial services in connection with the activities of such partnership or are personal service corporations (as defined in section 269A(b)) the owner-employees (as defined in section 269A(b)) of which perform such substantial services,

(B) are retired partners who had performed such substantial services, or

(C) are spouses of partners who are performing (or had previously performed) such substantial services.

(3) SPECIAL RULE FOR LOWER TIER PARTNERSHIPS.—For purposes of this subsection, the activities of a partnership shall include the activities of any other partnership in which the partnership owns directly an interest in the capital and profits of at least 80 percent.

(c) EXCLUSION OF COMMODITY POOLS.—For purposes of this part, an election under subsection (a) shall not be effective with respect to any partnership the principal activity of which is the buying and selling of commodities (not described in section 1221(1)), or options, futures, or forwards with respect to such commodities.

(d) SECRETARY MAY RELY ON TREATMENT ON RETURN.—If, on the partnership return of any partnership, such partnership is treated as an electing large partnership, such treatment shall be binding on such partnership and all partners of such partnership but not on the Secretary.

[CCH Explanation at ¶ 412-420. Committee Reports at ¶ 12,215.]

Amendment Notes

Act Sec. 1221(a) added Code Sec. 775 to read as above.

The above amendment applies to partnership tax years beginning after December 31, 1997.

[¶ 5243] *CODE SEC. 776. SPECIAL RULES FOR PARTNERSHIPS HOLDING OIL AND GAS PROPERTIES.*

(a) COMPUTATION OF PERCENTAGE DEPLETION.—In the case of an electing large partnership, except as provided in subsection (b)—

(1) the allowance for depletion under section 611 with respect to any partnership oil or gas property shall be computed at the partnership level without regard to any provision of section 613A requiring such allowance to be computed separately by each partner,

(2) such allowance shall be determined without regard to the provisions of section 613A(c) limiting the amount of production for which percentage depletion is allowable and without regard to paragraph (1) of section 613A(d), and

(3) paragraph (3) of section 705(a) shall not apply.

(b) TREATMENT OF CERTAIN PARTNERS.—

(1) IN GENERAL.—In the case of a disqualified person, the treatment under this chapter of such person's distributive share of any item of income, gain, loss, deduction, or credit attributable to any partnership oil or gas property shall be determined without regard to this part. Such person's distributive share of any such items shall be excluded for purposes of making determinations under sections 772 and 773.

(2) DISQUALIFIED PERSON.—For purposes of paragraph (1), the term "disqualified person" means, with respect to any partnership taxable year—

(A) any person referred to in paragraph (2) or (4) of section 613A(d) for such person's taxable year in which such partnership taxable year ends, and

(B) any other person if such person's average daily production of domestic crude oil and natural gas for such person's taxable year in which such partnership taxable year ends exceeds 500 barrels.

(3) AVERAGE DAILY PRODUCTION.—For purposes of paragraph (2), a person's average daily production of domestic crude oil and natural gas for any taxable year shall be computed as provided in section 613A(c)(2)—

(A) by taking into account all production of domestic crude oil and natural gas (including such person's proportionate share of any production of a partnership),

(B) by treating 6,000 cubic feet of natural gas as a barrel of crude oil, and

(C) by treating as 1 person all persons treated as 1 taxpayer under section 613A(c)(8) or among whom allocations are required under such section.

[CCH Explanation at ¶ 412-420. Committee Reports at ¶ 12,215.]

Amendment Notes

Act Sec. 1221(a) added Code Sec. 776 to read as above.

The above amendment applies to partnership tax years beginning after December 31, 1997.

[¶ 5245] *CODE SEC. 777. REGULATIONS.*

The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this part.

* * *

[CCH Explanation at ¶ 412-420. Committee Reports at ¶ 12,215.]

Amendment Notes

Act Sec. 1221(a) added Code Sec. 777 to read as above.

The above amendment applies to partnership tax years beginning after December 31, 1997.

[¶ 5247] CODE SEC. 805. GENERAL DEDUCTIONS.

(a) GENERAL RULE.—For purposes of this part, there shall be allowed the following deductions:

* * *

(4) DIVIDENDS RECEIVED BY COMPANY.—

* * *

(C) 100 PERCENT DIVIDEND.—For purposes of subparagraph (A)—

* * *

(ii) TREATMENT OF DIVIDENDS FROM NONINSURANCE COMPANIES.—The term "100 percent dividend" does not include any distribution by a corporation which is not an insurance company to the extent such distribution is out of tax-exempt interest, *or out of the increase for the taxable year in policy cash values (within the meaning of subparagraph (F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies,* or out of dividends which are not 100 percent dividends (determined with the application of this clause as if it applies to distributions by all corporations including insurance companies).

(D) SPECIAL RULES FOR CERTAIN DIVIDENDS FROM INSURANCE COMPANIES.—

* * *

(iii) PRORATED AMOUNTS.—For purposes of this subparagraph, the term "prorated amounts" means tax-exempt interest, *the increase for the taxable year in policy cash values (within the meaning of subparagraph (F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies, and* dividends other than 100 percent dividends.

* * *

(F) INCREASE IN POLICY CASH VALUES.—For purposes of subparagraphs (C) and (D)—

(i) IN GENERAL.—The increase in the policy cash value for any taxable year with respect to policy or contract is the amount of the increase in the adjusted cash value during such taxable year determined without regard to—

(I) gross premiums paid during such taxable year, and

(II) distributions (other than amounts includible in the policyholder's gross income) during such taxable year to which section 72(e) applies.

(ii) ADJUSTED CASH VALUE.—For purposes of clause (i), the term "adjusted cash value" means the cash surrender value of the policy or contract increased by the sum of—

(I) commissions payable with respect to such policy or contract for the taxable year, and

(II) asset management fees, surrender charges, mortality and expense charges, and any other fees or charges specified in regulations prescribed by the Secretary which are imposed (or which would be imposed were the policy or contract canceled) with respect to such policy or contract for the taxable year.

* * *

[CCH Explanation at ¶ 845. Committee Reports at ¶ 11,530.]

Amendment Notes

Act Sec. 1084(b)[(d)](1)(A) amended Code Sec. 805(a)(4)(C)(ii) by inserting ", or out of the increase for the taxable year in policy cash values (within the meaning of subparagraph (F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies," after "tax-exempt interest".

Act Sec. 1084(b)[(d)](1)(B) amended Code Sec. 805(a)(4)(D)(iii) by striking "and" and inserting ", the increase for the taxable year in policy cash values (within the meaning of subparagraph (F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies, and".

Act Sec. 1084(b)[(d)](1)(C) amended Code Sec. 805(a)(4) by adding at the end a new subparagraph (F) to read as above.

For the effective dates of the above amendments, see Act Sec. 1084(d)[(f)], below.

Act Sec. 1084(d)[(f)] provides:

(d)[(f)] EFFECTIVE DATE.—The amendments made by this section shall apply to contracts issued after June 8, 1997, in taxable years ending after such date. For purposes of the preceding sentence, any material increase in the death benefit or other material change in the contract shall be treated as a new contract but the addition of covered lives shall be treated as a new contract only with respect to such additional covered lives. For purposes of this subsection, an increase in the death benefit under a policy or contract issued in connection with a lapse described in section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 shall not be treated as a new contract.

[¶ 5249] CODE SEC. 807. RULES FOR CERTAIN RESERVES.

(a) DECREASE TREATED AS GROSS INCOME.—If for any taxable year—

* * *

(2)(A) the closing balance for such items, reduced by

(B) the sum of (i) the amount of the policyholders' share of tax-exempt *interest and the amount of the policyholder's share of the increase for the taxable year in policy cash values (within the meaning of section 805(a)(4)(F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies,* plus (ii) any excess described in section 809(a)(2) for the taxable year,

such excess shall be included in gross income under section 803(a)(2).

Amendment Notes

Act Sec. 1084(b)[(d)](2)(A) amended Code Sec. 807(a)(2)(B) by striking "interest," and inserting "interest and the amount of the policyholder's share of the increase for the taxable year in policy cash values (within the meaning of section 805(a)(4)(F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies,".

For the effective date of the above amendment, see Act Sec. 1084(d)[(f)], below.

Act Sec. 1084(d)[(f)] provides:

(d)[(f)] EFFECTIVE DATE.—The amendments made by this section shall apply to contracts issued after June 8, 1997, in taxable years ending after such date. For purposes of the preceding sentence, any material increase in the death benefit or other material change in the contract shall be treated as a new contract but the addition of covered lives shall be treated as a new contract only with respect to such additional covered lives. For purposes of this subsection, an increase in the death benefit under a policy or contract issued in connection with a lapse described in section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 shall not be treated as a new contract.

(b) INCREASE TREATED AS DEDUCTION.—If for any taxable year—

(1)(A) the closing balance for the items described in subsection (c), reduced by

(B) the sum of (i) the amount of the policyholders' share of tax-exempt *interest and the amount of the policyholder's share of the increase for the taxable year in policy cash values (within the meaning of section 805(a)(4)(F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies,* plus (ii) any excess described in section 809(a)(2) for the taxable year, exceeds

(2) the opening balance for such items,

such excess shall be taken into account as a deduction under section 805(a)(2).

* * *

[CCH Explanation at ¶ 845. Committee Reports at ¶ 11,530.]

Amendment Notes

Act Sec. 1084(b)[(d)](2)(B) amended Code Sec. 807(b)(1)(B) by striking "interest," and inserting "interest

and the amount of the policyholder's share of the increase for the taxable year in policy cash values (within the meaning of section 805(a)(4)(F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies,".

For the effective date of the above amendment, see Act Sec. 1084(d)[(f)], below.

Act Sec. 1084(d)[(f)] provides:

(d)[(f)] EFFECTIVE DATE.—The amendments made by this section shall apply to contracts issued after June 8, 1997, in taxable years ending after such date. For purposes of the preceding sentence, any material increase in the death benefit or other material change in the contract shall be treated as a new contract but the addition of covered lives shall be treated as a new contract only with respect to such additional covered lives. For purposes of this subsection, an increase in the death benefit under a policy or contract issued in connection with a lapse described in section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 shall not be treated as a new contract.

[¶ 5251] CODE SEC. 812. DEFINITION OF COMPANY'S SHARE AND POLICYHOLDERS' SHARE.

* * *

(d) GROSS INVESTMENT INCOME.—For purposes of this section, the term "gross investment income" means the sum of the following:

(1) INTEREST, ETC.—The gross amount of income from—

(A) interest (including tax-exempt interest), dividends, rents, and royalties,

(B) the entering into of any lease, mortgage, or other instrument or agreement from which the life insurance company derives interest, rents, or royalties,

(C) the alteration or termination of any instrument or agreement described in subparagraph (B), *and*

(D) the increase for any taxable year in the policy cash values (within the meaning of section 805(a)(4)(F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies.

* * *

[CCH Explanation at ¶ 845. Committee Reports at ¶ 11,530.]

Amendment Notes

Act Sec. 1084(b)[(d)](3) amended Code Sec. 812(d)(1) by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting ", and", and by adding at the end a new subparagraph (D) to read as above.

For the effective date of the above amendment, see Act Sec. 1084(d)[(f)], below.

Act Sec. 1084(d)[(f)] provides:

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to contracts issued after June 8, 1997, in taxable years ending after such date. For purposes of the preceding sentence, any material increase in the death benefit or other material change in the contract shall be treated as a new contract but the addition of covered lives shall be treated as a new contract only with respect to such additional covered lives. For purposes of this subsection, an increase in the death benefit under a policy or contract issued in connection with a lapse described in section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 shall not be treated as a new contract.

[¶ 5253] CODE SEC. 814. CONTIGUOUS COUNTRY BRANCHES OF DOMESTIC LIFE INSURANCE COMPANIES.

* * *

(h) SPECIAL RULE FOR DOMESTIC STOCK LIFE INSURANCE COMPANIES.—At the election of a domestic stock life insurance company which has a contiguous country life insurance branch described in subsection (b) (without regard to the mutual requirement in subsection (b)(3)), the assets of such branch may be transferred to a foreign corporation organized under the laws of the contiguous country without the application of section 367. Subsection (a) shall apply to the stock of such foreign corporation as if such domestic company were a mutual company and as if the stock were an item described in subsection (c). Subsection (e)(2) shall apply to amounts transferred or credited to such domestic company as if such domestic company and such foreign corporation constituted one domestic mutual life insurance company. The insurance contracts which may be transferred pursuant to this subsection shall include only those which are similar to the types of insurance contracts issued by a mutual life insurance company. Notwithstanding the first sentence of this subsection, if the aggregate fair market value of the invested assets and tangible property which are separately accounted for by the domestic life insurance company in the branch account exceeds the aggregate adjusted basis of such assets for purposes of determining gain, the domestic life insurance company shall be deemed to have sold all such assets on the first day of the taxable year for which the election under this subsection applies and the net gain shall be recognized to the domestic life insurance company on the deemed sale, but not in excess of the proportion of such net gain which equals the proportion which the aggregate fair market value of such assets which are transferred pursuant to this subsection is of the aggregate fair market value of all such assets.

* * *

[CCH Explanation at ¶ 968 and 969. Committee Reports at ¶ 11,735.]

Amendment Notes

Act Sec. 1131(c)[(d)](1) amended Code Sec. 814(h) by striking "or 1491" at the end of the first sentence.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5255] CODE SEC. 817. TREATMENT OF VARIABLE CONTRACTS.

* * *

(h) TREATMENT OF CERTAIN NONDIVERSIFIED CONTRACTS.—

* * *

(2) SAFE HARBOR FOR DIVERSIFICATION.—A segregated asset account shall be treated as meeting the requirements of paragraph (1) for any quarter of a taxable year if as of the close of such quarter—

(A) it meets the requirements of section *851(b)(3)*, and

(B) no more than 55 percent of the value of the total assets of the account are assets described in section *851(b)(3)(A)(i)*.

* * *

[CCH Explanation at ¶ 535. Committee Reports at ¶ 12,515.]

Amendment Notes

Act Sec. 1271(b)(8)(A)-(B) amended Code Sec. 817(h)(2) by striking "851(b)(4)" in subparagraph (A) and inserting "851(b)(3)", and by striking "851(b)(4)(A)(i)" in subparagraph (B) and inserting "851(b)(3)(A)(i)".

The above amendment applies to tax years beginning after the enactment of this Act.

[¶ 5257] CODE SEC. 832. INSURANCE COMPANY TAXABLE INCOME.

* * *

(b) DEFINITIONS.—In the case of an insurance company subject to the tax imposed by section 831—

* * *

(5) LOSSES INCURRED.—

* * *

(B) REDUCTION OF DEDUCTION.—The amount which would (but for this subparagraph) be taken into account under subparagraph (A) shall be reduced by an amount equal to 15 percent of the sum of—

(i) tax-exempt interest received or accrued during such taxable year,

(ii) the aggregate amount of deductions provided by sections 243, 244, and 245 for—

(I) dividends (other than 100 percent dividends) received during the taxable year, and

(II) 100 percent dividends received during the taxable year to the extent attributable (directly or indirectly) to prorated amounts*, and*

(iii) the increase for the taxable year in policy cash values (within the meaning of section 805(a)(4)(F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies.

In the case of a 100 percent dividend paid by an insurance company, the portion attributable to prorated amounts shall be determined under subparagraph (E)(ii).

* * *

[CCH Explanation at ¶ 845. Committee Reports at ¶ 11,530.]

Amendment Notes

Act Sec. 1084(b)[(d)](4) amended Code Sec. 832(b)(5)(B) by striking "and" at the end of clause (i), by striking the period at the end of clause (ii) and inserting ", and", and by adding at the end a new clause (iii) to read as above.

For the effective date of the above amendment, see Act Sec. 1084(d)[(f)], below.

Act Sec. 1084(d)[(f)] provides:

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to contracts issued after June 8, 1997, in taxable years ending after such date. For purposes of the preceding sentence, any material increase in the death benefit or other material change in the contract shall be treated as a new contract but the addition of covered lives shall be treated as a new contract only with respect to such additional covered lives. For purposes of this subsection, an increase in the death benefit under a policy or contract issued in connection with a lapse described in section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 shall not be treated as a new contract.

[¶ 5259] CODE SEC. 833. TREATMENT OF BLUE CROSS AND BLUE SHIELD ORGANIZATIONS, ETC.

* * *

(b) AMOUNT OF DEDUCTION.—

(1) IN GENERAL.—Except as provided in paragraph (2), the deduction determined under this subsection for any taxable year is the excess (if any) of—

(A) 25 percent of the sum of—

(i) the claims incurred during the taxable year *and liabilities incurred during the taxable year under cost-plus contracts,* and

(ii) the expenses incurred during the taxable year in connection with the administration, adjustment, or settlement of claims *or in connection with the administration of cost-plus contracts,* over

(B) the adjusted surplus as of the beginning of the taxable year.

* * *

[CCH Explanation at ¶ 577. Committee Reports at ¶ 13,945.]

Amendment Notes

Act Sec. 1604(d)(2)(A)(i)-(ii) amended Code Sec. 833(b)(1)(A) by inserting before the comma at the end of clause (i) "and liabilities incurred during the taxable year under cost-plus contracts", and by inserting before the comma at the end of clause (ii) "or in connection with the administration of cost-plus contracts".

The above amendment is effective as if included in the amendments made by Act Sec. 1012 of the Tax Reform Act of 1986 (P.L. 99-514) [generally effective for tax years beginning after December 31, 1986.—CCH.].

[¶ 5261] CODE SEC. 851. DEFINITION OF REGULATED INVESTMENT COMPANY.

* * *

(b) LIMITATIONS.—A corporation shall not be considered a regulated investment company for any taxable year unless—

(1) it files with its return for the taxable year an election to be a regulated investment company or has made such election for a previous taxable year;

(2) at least 90 percent of its gross income is derived from dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and gains from the sale or other disposition of stock or securities (as defined in section 2(a)(36) of the Investment Company Act of 1940, as amended) or foreign currencies, or other income (including but not limited to gains from options, futures, or forward contracts) derived with respect to its business of investing in such stock, securities, or currencies; *and*

(3) at the close of each quarter of the taxable year—

(A) at least 50 percent of the value of its total assets is represented by—

(i) cash and cash items (including receivables), Government securities and securities of other regulated investment companies, and

(ii) other securities for purposes of this calculation limited, except and to the extent provided in subsection (e), in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the taxpayer and to not more than 10 percent of the outstanding voting securities of such issuer, and

(B) not more than 25 percent of the value of its total assets is invested in the securities (other than Government securities or the securities of other regulated investment companies) of any one issuer, or of two or more issuers which the taxpayer controls and which are determined, under regulations prescribed by the Secretary, to be engaged in the same or similar trades or businesses or related trades or businesses.

For purposes of paragraph (2), the Secretary may by regulation exclude from qualifying income foreign currency gains which are not directly related to the company's principal business of investing in stock or securities (or options and futures with respect to stock or securities). For purposes of paragraph (2), there shall be treated as dividends amounts included in gross income under section 951(a)(1)(A)(i) or 1293(a) for the taxable year to the extent that, under section 959(a)(1) or 1293(c) (as the case may be), there is a distribution out of the earnings and profits of the taxable year which are attributable to the amounts so included. For purposes of *paragraph (2),* amounts excludable from gross income under section 103(a) shall be treated as included in gross income. Income derived from a partnership or trust shall be treated as described in paragraph (2) only to the extent such income is

attributable to items of income of the partnership or trust (as the case may be) which would be described in paragraph (2) if realized by the regulated investment company in the same manner as realized by the partnership or trust.

Amendment Notes

Act Sec. 1271(a) amended Code Sec. 851(b) by striking paragraph (3), by adding "and" at the end of paragraph (2), and by redesignating paragraph (4) as paragraph (3). Prior to amendment, Code Sec. 851(b)(3) read as follows:

(3) less than 30 percent of its gross income is derived from the sale or disposition of any of the following which was held for less than 3 months:

(A) stock or securities (as defined in section 2(a)(36) of the Investment Company Act of 1940, as amended),

(B) options, futures, or forward contracts (other than options, futures, or forward contracts on foreign currencies), or

(C) foreign currencies (or options, futures, or forward contracts on foreign currencies) but only if such currencies (or options, futures, or forward contracts) are not directly related to the company's principal business of investing in stock or securities (or options and futures with respect to stocks or securities), and

Act Sec. 1271(b)(1)(A)-(B) amended the material following Code Sec. 851(b)(3) (as redesignated by Act Sec. 1271(a)) by striking out "paragraphs (2) and (3)" and inserting "paragraph (2)", and by striking out the last sentence. Prior to amendment, the last sentence of Code Sec. 851(b)(3) read as follows:

In the case of the taxable year in which a regulated investment company is completely liquidated, there shall not be taken into account under paragraph (3) any gain from the sale, exchange, or distribution of any property after the adoption of the plan of complete liquidation.

The above amendments apply to tax years beginning after the date of the enactment of this Act.

(c) RULES APPLICABLE TO *SUBSECTION (b)(3)*.—For purposes of *subsection (b)(3)* and this subsection—

(1) In ascertaining the value of the taxpayer's investment in the securities of an issuer, for the purposes of subparagraph (B), there shall be included its proper proportion of the investment of any other corporation, a member of a controlled group, in the securities of such issuer, as determined under regulations prescribed by the Secretary.

(2) The term "controls" means the ownership in a corporation of 20 percent or more of the total combined voting power of all classes of stock entitled to vote.

(3) The term "controlled group" means one or more chains of corporations connected through stock ownership with the taxpayer if—

(A) 20 percent or more of the total combined voting power of all classes of stock entitled to vote of each of the corporations (except the taxpayer) is owned directly by one or more of the other corporations, and

(B) the taxpayer owns directly 20 percent or more of the total combined voting power of all classes of stock entitled to vote, of at least one of the other corporations.

(4) The term "value" means, with respect to securities (other than those of majority-owned subsidiaries) for which market quotations are readily available, the market value of such securities; and with respect to other securities and assets, fair value as determined in good faith by the board of directors, except that in the case of securities of majority-owned subsidiaries which are investment companies such fair value shall not exceed market value or asset value, whichever is higher.

(5) All other terms shall have the same meaning as when used in the Investment Company Act of 1940, as amended.

Amendment Notes

Act Sec. 1271(b)(2) amended Code Sec. 851(c) by striking "subsection (b)(4)" each place it appears (including the heading) and inserting "subsection (b)(3)".

The above amendment applies to tax years beginning after the date of the enactment of this Act.

(d) DETERMINATION OF STATUS.—A corporation which meets the requirements of *subsections (b)(3)* and (c) at the close of any quarter shall not lose its status as a regulated investment company because of a discrepancy during a subsequent quarter between the value of its various investments and such requirements unless such discrepancy exists immediately after the acquisition of any security or other property and is wholly or partly the result of such acquisition. A corporation which does not meet such requirements at the close of any quarter by reason of a discrepancy existing immediately after the acquisition of any security or other property which is wholly or partly the result of such acquisition during such quarter shall not lose its status for such quarter as a regulated investment company if such discrepancy is eliminated within 30 days after the close of such quarter and in such cases it shall be considered to have met such requirements at the close of such quarter for purposes of applying the preceding sentence.

Amendment Notes

Act Sec. 1271(b)(3) amended Code Sec. 851(d) by striking "subsections (b)(4)" and inserting "subsections (b)(3)".

The above amendment applies to tax years beginning after the date of the enactment of this Act.

(e) INVESTMENT COMPANIES FURNISHING CAPITAL TO DEVELOPMENT CORPORATIONS.—

(1) GENERAL RULE.—If the Securities and Exchange Commission determines, in accordance with regulations issued by it, and certifies to the Secretary not earlier than 60 days prior to the close of the taxable year of a management company or a business development company described in subsection (a)(1), that such investment company is principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available, such investment company may, in the computation of 50 percent of the value of its assets under subparagraph (A) of *subsection (b)(3)* for any quarter of such taxable year, include the value of any securities of an issuer, whether or not the investment company owns more than 10 percent of the outstanding voting securities of such issuer, the basis of which, when added to the basis of the investment company for securities of such issuer previously acquired, did not exceed 5 percent of the value of the total assets of the investment company at the time of the subsequent acquisition of securities. The preceding sentence shall not apply to the securities of an issuer if the investment company has continuously held any security of such issuer (or of any predecessor company of such issuer as determined under regulations prescribed by the Secretary) for 10 or more years preceding such quarter of such taxable year.

* * *

(4) DEFINITIONS.—The terms used in this subsection shall have the same meaning as in *subsections (b)(3)* and (c) of this section.

* * *

Amendment Notes

Act Sec. 1271(b)(4) amended Code Sec. 851(e)(1) by striking "subsection (b)(4)" and inserting "subsection (b)(3)".

Act Sec. 1271(b)(5) amended Code Sec. 851(e)(4) by striking "subsections (b)(4)" and inserting "subsections (b)(3)".

The above amendments apply to tax years beginning after the date of the enactment of this Act.

(g) SPECIAL RULE FOR SERIES FUNDS.—

(1) IN GENERAL.—In the case of a regulated investment company (within the meaning of subsection (a)) having more than one fund, each fund of such regulated investment company shall be treated as a separate corporation for purposes of this title (except with respect to the definitional requirement of subsection (a)).

(2) FUND DEFINED.—For purposes of paragraph (1) the term "fund" means a segregated portfolio of assets, the beneficial interests in which are owned by the holders of a class or series of stock of the regulated investment company that is preferred over all other classes or series in respect of such portfolio of assets.

[CCH Explanation at ¶ 535. Committee Reports at ¶ 12,515.]

Amendment Notes

Act Sec. 1271(b)(6) amended Code Sec. 851 by striking subsection (g) and redesignating subsection (h) as subsection (g). Prior to being stricken, Code Sec. 851(g) read as follows:

(g) TREATMENT OF CERTAIN HEDGING TRANSACTIONS.—

(1) IN GENERAL.—In the case of any designated hedge, for purposes of subsection (b)(3), increases (and decreases) during the period of the hedge in the value of positions which are part of such hedge shall be netted.

(2) DESIGNATED HEDGE.—For purposes of this subsection, there is a designated hedge where—

(A) the taxpayer's risk of loss with respect to any position in property is reduced by reason of—

(i) the taxpayer having an option to sell, being under a contractual obligation to sell, or having made (and not closed) a short sale of substantially identical property,

(ii) the taxpayer being the grantor of an option to buy substantially identical property, or

(iii) under regulations prescribed by the Secretary, the taxpayer holding 1 or more other positions, and

(B) the positions which are part of the hedge are clearly identified by the taxpayer in the manner prescribed by regulations.

Act Sec. 1271(b)(7) amended Code Sec. 851(g) (as redesignated by Act Sec. 1271(b)(6)) by striking paragraph (3). Prior to amendment, Code Sec. 851(g)(3) read as follows:

(3) SPECIAL RULE FOR ABNORMAL REDEMPTIONS.—

(A) IN GENERAL.—Any fund treated as a separate corporation under paragraph (1) shall not be disqualified under subsection (b)(3) for any taxable year by reason of sales resulting from abnormal redemptions on any day and occurring before the close of the 5th business day after such day if—

(i) the sum of the percentages determined under subparagraph (B) for the abnormal redemptions on such day and for abnormal redemptions on prior days during such taxable year exceeds 30 percent; and

(ii) the regulated investment company of which such fund is a part would meet the requirements of subsection (b)(3) for such taxable year if all the funds which are part of such company were treated as a single company.

(B) ABNORMAL REDEMPTIONS.—For purposes of subparagraph (A), the term "abnormal redemptions" means redemptions occurring on any day if the net redemptions on such day exceed 1 percent of the fund's net asset value.

(C) DETERMINATION OF NET ASSET VALUE.—For purposes of this paragraph, net asset value for any day shall be determined as of the close of the preceding day.

(D) LIMITATION.—For purposes of subparagraph (A), any sale or other disposition of stock or securities held less than 3 months occurring during any day shall be deemed to result from abnormal redemptions until the cumulative proceeds from such sales or dispositions occurring during such day, plus the cumulative net positive cash flow of the fund for preceding business days (if any) following the day with

abnormal redemptions, exceed the amount of net redemptions on the day with abnormal redemptions.

The above amendment applies to tax years beginning after the enactment of this Act.

[¶ 5263] CODE SEC. 852. TAXATION OF REGULATED INVESTMENT COMPANIES AND THEIR SHAREHOLDERS.

* * *

(b) METHOD OF TAXATION OF COMPANIES AND SHAREHOLDERS.—

* * *

(3) CAPITAL GAINS.—

* * *

(D) TREATMENT BY SHAREHOLDERS OF UNDISTRIBUTED CAPITAL GAINS.—

(i) Every shareholder of a regulated investment company at the close of the company's taxable year shall include, in computing his long-term capital gains in his return for his taxable year in which the last day of the company's taxable year falls, such amount as the company shall designate in respect of such shares in a written notice mailed to its shareholders at any time prior to the expiration of 60 days after close of its taxable year, but the amount so includible by any shareholder shall not exceed that part of the amount subjected to tax in subparagraph (A) which he would have received if all of such amount had been distributed as capital gain dividends by the company to the holders of such shares at the close of its taxable year.

(ii) For purposes of this title, every such shareholder shall be deemed to have paid, for his taxable year under clause (i), the tax imposed by subparagraph (A) on the amounts required by this subparagraph to be included in respect of such shares in computing his long-term capital gains for that year; and such shareholder shall be allowed credit or refund, as the case may be, for the tax so deemed to have been paid by him.

(iii) The adjusted basis of such shares in the hands of the shareholder shall be increased, with respect to the amounts required by this subparagraph to be included in computing his long-term capital gains, *by the difference between the amount of such includible gains and the tax deemed paid by such shareholder in respect of such shares under clause (ii).*

(iv) In the event of such designation the tax imposed by subparagraph (A) shall be paid by the regulated investment company within 30 days after close of its taxable year.

(v) The earnings and profits of such regulated investment company, and the earnings and profits of any such shareholder which is a corporation, shall be appropriately adjusted in accordance with regulations prescribed by the Secretary.

* * *

(10) SPECIAL RULE FOR CERTAIN LOSSES ON STOCK IN PASSIVE FOREIGN INVESTMENT COMPANY.—To the extent provided in regulations, the taxable income of a regulated investment company (other than a company to which an election under section 4982(e)(4) applies) shall be computed without regard to any net reduction in the value of any stock of a passive foreign investment company with respect to which an election under section 1296(k) is in effect occurring after October 31 of the taxable year, and any such reduction shall be treated as occurring on the first day of the following taxable year.

Amendment Notes

Act Sec. 1122(c)(2) amended Code Sec. 852(b) by adding at the end thereof a new paragraph (10) to read as above.

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and to tax years of foreign corporations ending with or within such tax years of United States persons.

Act Sec. 1254(b)(2) amended Code Sec. 852(b)(3)(D)(iii) by striking "by 65 percent" and all that follows and inserting "by the difference between the amount of such includible gains and the tax deemed paid by such shareholder in respect of such shares under clause (ii).". Prior to amendment, Code Sec. 852(b)(3)(D)(iii) read as follows:

(iii) The adjusted basis of such shares in the hands of the shareholder shall be increased, with respect to the amounts required by this subparagraph to be included in computing his long-term capital gains, by 65 percent of so much of such amounts as equals the amount subject to tax in accordance with section 1201(a).

The above amendment applies to tax years beginning after the date of the enactment of this Act.

(c) EARNINGS AND PROFITS.—

* * *

(2) COORDINATION WITH TAX ON UNDISTRIBUTED INCOME.—For purposes of applying this chapter to distributions made by a regulated investment company with respect to any calendar year, the earnings and profits of such company shall be determined without regard to any net capital loss (or net foreign currency loss) attributable to transactions after October 31 of such year, *without regard*

to any net reduction in the value of any stock of a passive foreign investment company with respect to which an election under section 1296(k) is in effect occurring after October 31 of such year, and with such other adjustments as the Secretary may by regulations prescribe. The preceding sentence shall apply—

(A) only to the extent that the amount distributed by the company with respect to the calendar year does not exceed the required distribution for such calendar year (as determined under section 4982 by substituting "100 percent" for each percentage set forth in section 4982(b)(1)), and

(B) except as provided in regulations, only if an election under section 4982(e)(4) is not in effect with respect to such company.

* * *

[CCH Explanation at ¶ 545 and 946. Committee Reports at ¶ 11,690 and 12,450.]

Amendment Notes

Act Sec. 1122(c)(3) amended Code Sec. 852(c)[2] by inserting ", without regard to any net reduction in the value of any stock of a passive foreign investment company with respect to which an election under section 1296(k) is in effect occurring after October 31 of such year," after "October 31 of such year".

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and to tax years of foreign corporations ending with or within such tax years of United States persons.

[¶ 5265] CODE SEC. 853. FOREIGN TAX CREDIT ALLOWED TO SHAREHOLDERS.

* * *

(c) NOTICE TO SHAREHOLDERS.—The amounts to be treated by the shareholder, for purposes of subsection (b) (2), as his proportionate share of—

(1) taxes paid to any foreign country or possession of the United States, and

(2) gross income derived from sources within any foreign country or possession of the United States,

shall not exceed the amounts so designated by the company in a written notice mailed to its shareholders not later than 60 days after the close of its taxable year. *Such notice shall also include the amount of such taxes which (without regard to the election under this section) would not be allowable as a credit under section 901(a) to the regulated investment company by reason of section 901(k).*

* * *

[CCH Explanation at ¶ 917. Committee Reports at ¶ 11,375.]

Amendment Notes

Act Sec. 1053(b) amended Code Sec. 853(c) by adding at the end a new sentence to read as above.

The above amendment applies to dividends paid or accrued more than 30 days after the date of the enactment of this Act.

[¶ 5267] CODE SEC. 856. DEFINITION OF REAL ESTATE INVESTMENT TRUST.

(a) IN GENERAL.—For purposes of this title, the term "real estate investment trust" means a corporation, trust or association—

(1) which is managed by one or more trustees or directors;

(2) the beneficial ownership of which is evidenced by transferable shares, or by transferable certificates of beneficial interest;

(3) which (but for the provisions of this part) would be taxable as a domestic corporation;

(4) which is neither (A) a financial institution referred to in section 582(c)(2), nor (B) an insurance company to which subchapter L applies;

(5) the beneficial ownership of which is held by 100 or more persons;

(6) *subject to the provisions of subsection (k),* which is not closely held (as determined under subsection (h)); and

(7) which meets the requirements of subsection (c).

* * *

Amendment Notes

Act Sec. 1251(b)(2) amended Code Sec. 856(a)(6) by inserting "subject to the provisions of subsection (k)," before "which is not".

The above amendment applies to tax years beginning after the date of the enactment of this Act.

(c) LIMITATIONS.—A corporation, trust, or association shall not be considered a real estate investment trust for any taxable year unless—

(1) it files with its return for the taxable year an election to be a real estate investment trust or has made such election for a previous taxable year, and such election has not been terminated or revoked under subsection (g):

(2) at least 95 percent (90 percent for taxable years beginning before January 1, 1980) of its gross income (excluding gross income from prohibited transactions) is derived from—

(A) dividends;

(B) interest;

(C) rents from real property;

(D) gain from the sale or other disposition of stock, securities, and real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(1);

(E) abatements and refunds of taxes on real property;

(F) income and gain derived from foreclosure property (as defined in subsection (e));

(G) amounts (other than amounts the determination of which depends in whole or in part on the income or profits of any person) received or accrued as consideration for entering into agreements (i) to make loans secured by mortgages on real property or on interests in real property or (ii) to purchase or lease real property (including interests in real property and interests in mortgages on real property); and

(H) gain from the sale or other disposition of a real estate asset which is not a prohibited transaction solely by reason of section 857(b)(6);

(3) at least 75 percent of its gross income (excluding gross income from prohibited transactions) is derived from—

(A) rents from real property;

(B) interest on obligations secured by mortgages on real property or on interests in real property;

(C) gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(1);

(D) dividends or other distributions on, and gain (other than gain from prohibited transactions) from the sale or other disposition of, transferable shares (or transferable certificates of beneficial interest) in other real estate investment trusts which meet the requirements of this part;

(E) abatements and refunds of taxes on real property;

(F) income and gain derived from foreclosure property (as defined in subsection (e));

(G) amounts (other than amounts the determination of which depends in whole or in part on the income or profits of any person) received or accrued as consideration for entering into agreements (i) to make loans secured by mortgages on real property or on interests in real property or (ii) to purchase or lease real property (including interests in real property and interests in mortgages on real property);

(H) gain from the sale or other disposition of a real estate asset which is not a prohibited transaction solely by reason of section 857(b)(6); and

(I) qualified temporary investment income; *and*

(4) at the close of each quarter of the taxable year—

(A) at least 75 percent of the value of its total assets is represented by real estate assets, cash and cash items (including receivables), and Government securities; and

(B) not more than 25 percent of the value of its total assets is represented by securities (other than those includible under subparagraph (A)) for purposes of this calculation limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the trust and to not more than 10 percent of the outstanding voting securities of such issuer.

A real estate investment trust which meets the requirements of this paragraph at the close of any quarter shall not lose its status as a real estate investment trust because of a discrepancy during a

subsequent quarter between the value of its various investments and such requirements unless such discrepancy exists immediately after the acquisition of any security or other property and is wholly or partly the result of such acquisition. A real estate investment trust which does not meet such requirements at the close of any quarter by reason of a discrepancy existing immediately after the acquisition of any security or other property which is wholly or partly the result of such acquisition during such quarter shall not lose its status for such quarter as a real estate investment trust if such discrepancy is eliminated within 30 days after the close of such quarter and in such cases it shall be considered to have met such requirements at the close of such quarter for purposes of applying the preceding sentence.

(5) For purposes of this part—

(A) The term "value" means, with respect to securities for which market quotations are readily available, the market value of such securities; and with respect to other securities and assets, fair value as determined in good faith by the trustees, except that in the case of securities of real estate investment trusts such fair value shall not exceed market value or asset value, whichever is higher.

(B) The term "real estate assets" means real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other real estate investment trusts which meet the requirements of this part. Such term also includes any property (not otherwise a real estate asset) attributable to the temporary investment of new capital, but only if such property is stock or a debt instrument, and only for the 1-year period beginning on the date the real estate trust receives such capital.

(C) The term "interests in real property" includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon, but does not include mineral, oil, or gas royalty interests.

(D) QUALIFIED TEMPORARY INVESTMENT INCOME.—

(i) IN GENERAL.—The term "qualified temporary investment income" means any income which—

(I) is attributable to stock or a debt instrument (within the meaning of section 1275(a)(1)),

(II) is attributable to the temporary investment of new capital, and

(III) is received or accrued during the 1-year period beginning on the date on which the real estate investment trust receives such capital.

(ii) NEW CAPITAL.—The term "new capital" means any amount received by the real estate investment trust—

(I) in exchange for stock (or certificates of beneficial interests) in such trust (other than amounts received pursuant to a dividend reinvestment plan), or

(II) in a public offering of debt obligations of such trust which have maturities of at least 5 years.

(E) A regular or residual interest in a REMIC shall be treated as a real estate asset, and any amount includible in gross income with respect to such an interest shall be treated as interest on an obligation secured by a mortgage on real property; except that, if less than 95 percent of the assets of such REMIC are real estate assets (determined as if the real estate investment trust held such assets), such real estate investment trust shall be treated as holding directly (and as receiving directly) its proportionate share of the assets and income of the REMIC. For purposes of determining whether any interest in a REMIC qualifies under the preceding sentence, any interest held by such REMIC in another REMIC shall be treated as a real estate asset under principles similar to the principles of the preceding sentence, except that, if such REMIC's are part of a tiered structure, they shall be treated as one REMIC for purposes of this subparagraph. The principles of the preceding provisions of this subparagraph shall apply to regular interests in a FASIT.

(F) All other terms shall have the same meaning as when used in the Investment Company Act of 1940, as amended (15 U.S.C. 80a-1 and following).

(G) TREATMENT OF CERTAIN HEDGING INSTRUMENTS.—Except to the extent provided by regulations, any—

(i) payment to a real estate investment trust under an interest rate swap or cap agreement, option, futures contract, forward rate agreement, or any similar financial instrument, entered into by the trust in a transaction to reduce the interest rate risks with respect to any indebtedness incurred or to be incurred by the trust to acquire or carry real estate assets, and

(ii) gain from the sale or other disposition of any such investment,

shall be treated as income qualifying under paragraph (2).

(6) A corporation, trust, or association which fails to meet the requirements of paragraph (2) or (3), or of both such paragraphs, for any taxable year shall nevertheless be considered to have satisfied the requirements of such paragraphs for such taxable year if—

(A) the nature and amount of each item of its gross income described in such paragraphs is set forth in a schedule attached to its income tax return for such taxable year;

(B) the inclusion of any incorrect information in the schedule referred to in subparagraph (A) is not due to fraud with intent to evade tax; and

(C) the failure to meet the requirements of paragraph (2) or (3), or of both such paragraphs, is due to reasonable cause and not due to willful neglect.

Amendment Notes

Act Sec. 1255(a)(1)-(3) amended Code Sec. 856(c) by adding "and" at the end of paragraph (3), by striking paragraphs (4) and (8), and by redesignating paragraphs (5), (6), and (7) as paragraphs (4), (5), and (6), respectively. Prior to amendment, Code Sec. 856(c)(4) and (8) read as follows:

(4) less than 30 percent of its gross income is derived from the sale or other disposition of—

(A) stock or securities held for less than 1 year;

(B) property in a transaction which is a prohibited transaction; and

(C) real property (including interests in real property and interests in mortgages on real property) held for less than 4 years other than—

(i) property compulsorily or involuntarily converted within the meaning of section 1033, and

(ii) property which is foreclosure property within the definition of section 856(e); and

* * *

(8) TREATMENT OF LIQUIDATING GAINS.—In the case of the taxable year in which a real estate investment trust is completely liquidated, there shall not be taken into account under paragraph (4) any gain from the sale, exchange, or distribution of any property after the adoption of the plan of complete liquidation.

Act Sec. 1255(b)(1) amended Code Sec. 856(c)(5)(G), as redesignated by Act Sec. 1255(a)(3), by striking "and such agreement shall be treated as a security for purposes of paragraph (4)(A)" after "paragraph (2)".

Act Sec. 1258 amended Code Sec. 856(c)(5)(G), as redesignated by Act Sec. 1255, to read as above. Prior to amendment, Code Sec. 856(c)(5)(G) read as follows:

(G) TREATMENT OF CERTAIN INTEREST RATE AGREEMENTS.—Except to the extent provided by regulations, any—

(i) payment to a real estate investment trust under a bona fide interest rate swap or cap agreement entered into by the real estate investment trust to hedge any variable rate indebtedness of such trust incurred or to be incurred to acquire or carry real estate assets, and

(ii) any gain from the sale or other disposition of such agreement,

shall be treated as income qualifying under paragraph (2).

The above amendments apply to tax years beginning after the date of the enactment of this Act.

(d) RENTS FROM REAL PROPERTY DEFINED.—

* * *

(2) AMOUNTS EXCLUDED.—For purposes of paragraphs (2) and (3) of subsection (c), the term "rents from real property" does not include—

(A) except as provided in paragraphs (4) and (6), any amount received or accrued, directly or indirectly, with respect to any real or personal property, if the determination of such amount depends in whole or in part on the income or profits derived by any person from such property (except that any amount so received or accrued shall not be excluded from the term "rents from real property" solely by reason of being based on a fixed percentage or percentages of receipts or sales);

(B) any amount received or accrued directly or indirectly from any person if the real estate investment trust owns, directly or indirectly—

(i) in the case of any person which is a corporation, stock of such person possessing 10 percent or more of the total combined voting power of all classes of stock entitled to vote, or 10 percent or more of the total number of shares of all classes of stock of such person; or

(ii) in the case of any person which is not a corporation, an interest of 10 percent or more in the assets or net profits of such person; and

(C) any impermissible tenant service income (as defined in paragraph (7)).

* * *

(5) CONSTRUCTIVE OWNERSHIP OF STOCK.—For purposes of this subsection, the rules prescribed by section 318(a) for determining the ownership of stock shall apply in determining the ownership of stock, assets, or net profits of any person; *except that—*

(A) "10 percent" shall be substituted for "50 percent" in subparagraph (C) of paragraphs (2) and (3) of section 318(a), and

(B) section 318(a)(3)(A) shall be applied in the case of a partnership by taking into account only partners who own (directly or indirectly) 25 percent or more of the capital interest, or the profits interest, in the partnership.

* * *

(7) IMPERMISSIBLE TENANT SERVICE INCOME.—For purposes of paragraph (2)(C)—

(A) IN GENERAL.—The term "impermissible tenant service income" means, with respect to any real or personal property, any amount received or accrued directly or indirectly by the real estate investment trust for—

(i) services furnished or rendered by the trust to the tenants of such property, or

(ii) managing or operating such property.

(B) DISQUALIFICATION OF ALL AMOUNTS WHERE MORE THAN DE MINIMIS AMOUNT.—If the amount described in subparagraph (A) with respect to a property for any taxable year exceeds 1 percent of all amounts received or accrued during such taxable year directly or indirectly by the real estate investment trust with respect to such property, the impermissible tenant service income of the trust with respect to the property shall include all such amounts.

(C) EXCEPTIONS.—For purposes of subparagraph (A)—

(i) services furnished or rendered, or management or operation provided, through an independent contractor from whom the trust itself does not derive or receive any income shall not be treated as furnished, rendered, or provided by the trust, and

(ii) there shall not be taken into account any amount which would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2).

(D) AMOUNT ATTRIBUTABLE TO IMPERMISSIBLE SERVICES.—For purposes of subparagraph (A), the amount treated as received for any service (or management or operation) shall not be less than 150 percent of the direct cost of the trust in furnishing or rendering the service (or providing the management or operation).

(E) COORDINATION WITH LIMITATIONS.—For purposes of paragraphs (2) and (3) of subsection (c), amounts described in subparagraph (A) shall be included in the gross income of the corporation, trust, or association.

Amendment Notes

Act Sec. 1252(a) amended Code Sec. 856(d)(2) by striking subparagraph (C) and the last sentence and inserting a new subparagraph (C) to read as above. Prior to amendment, Code Sec. 856(d)(2)(C) and the last sentence read as follows:

(C) any amount received or accrued, directly or indirectly, with respect to any real or personal property if the real estate investment trust furnishes or renders services to the tenants of such property, or manages or operates such property, other than through an independent contractor from whom the trust itself does not derive or receive any income

Subparagraph (C) shall not apply with respect to any amount if such amount would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2).

Act Sec. 1252(b) amended Code Sec. 856(d) by adding at the end a new paragraph (7) to read as above.

Act Sec. 1253 amended Code Sec. 856(d)(5) by striking "except that" and all that follows and inserting "except that—" and subparagraphs (A) and (B) to read as above. Prior to amendment, Code Sec. 856(d)(5) read as follows:

(5) CONSTRUCTIVE OWNERSHIP OF STOCK.—For purposes of this subsection, the rules prescribed by section 318(a) for determining the ownership of stock shall apply in determining the ownership of stock, assets, or net profits of any person, except that "10 percent" shall be substituted for "50 percent" in subparagraph (C) of section 318(a)(2) and 318(a)(3).

The above amendments apply to tax years beginning after the date of the enactment of this Act.

(e) SPECIAL RULES FOR FORECLOSURE PROPERTY.—

* * *

(2) GRACE PERIOD.—Except as provided in paragraph (3), property shall cease to be foreclosure property with respect to the real estate investment trust as *of the close of the 3d taxable year following the taxable year in which the trust acquired such property.*

(3) EXTENSIONS.—If the real estate investment trust establishes to the satisfaction of the Secretary that an extension of the grace period is necessary for the orderly liquidation of the trust's interests in such property, the Secretary may grant one *extension* of the grace period for such

property. *Any such extension shall not extend the grace period beyond the close of the 3d taxable year following the last taxable year in the period under paragraph (2).*

(4) TERMINATION OF GRACE PERIOD IN CERTAIN CASES.—Any foreclosure property shall cease to be such on the first day (occurring on or after the day on which the real estate investment trust acquired the property) on which—

(A) a lease is entered into with respect to such property which, by its terms, will give rise to income which is not described in subsection (c)(3) (other than subparagraph (F) of such subsection), or any amount is received or accrued, directly or indirectly, pursuant to a lease entered into on or after such day which is not described in such subsection,

(B) any construction takes place on such property (other than completion of a building, or completion of any other improvement, where more than 10 percent of the construction of such building or other improvement was completed before default became imminent), or

(C) if such day is more than 90 days after the day on which such property was acquired by the real estate investment trust and the property is used in a trade or business which is conducted by the trust (other than through an independent contractor (within the meaning of section (d)(3)) from whom the trust itself does not derive or receive any income).

For purposes of subparagraph (C), property shall not be treated as used in a trade or business by reason of any activities of the real estate investment trust with respect to such property to the extent that such activities would not result in amounts received or accrued, directly or indirectly, with respect to such property being treated as other than rents from real property.

(5) TAXPAYER MUST MAKE ELECTION.—Property shall be treated as foreclosure property for purposes of this part only if the real estate investment trust so elects (in the manner provided in regulations prescribed by the Secretary) on or before the due date (including any extensions of time) for filing its return of tax under this chapter for the taxable year in which such trust acquires such property. *A real estate investment trust may revoke any such election for a taxable year by filing the revocation (in the manner provided by the Secretary) on or before the due date (including any extension of time) for filing its return of tax under this chapter for the taxable year. If a trust revokes an election for any property, no election may be made by the trust under this paragraph with respect to the property for any subsequent taxable year.*

* * *

Amendment Notes

Act Sec. 1257(a)(1) amended Code Sec. 856(e)(2) by striking "on the date which is 2 years after the date the trust acquired such property" and inserting "as of the close of the 3d taxable year following the taxable year in which the trust acquired such property".

Act Sec. 1257(a)(2)(A)-(B) amended Code Sec. 856(e)(3) by striking "or more extensions" and inserting "extension", and by striking the last sentence and inserting a new sentence to read as above. Prior to amendment, the last sentence of Code Sec. 856(e)(3) read as follows:

Any such extension shall not extend the grace period beyond the date which is 6 years after the date such trust acquired such property.

Act Sec. 1257(b) amended Code Sec. 856(e)(5) by striking the last sentence and inserting two new sentences to read as above. Prior to amendment, the last sentence of Code Sec. 856(e)(5) read as follows:

Any such election shall be irrevocable.

Act Sec. 1257(c) amended Code Sec. 856(e)(4) by adding at the end a new flush sentence to read as above.

The above amendments apply to tax years beginning after the date of the enactment of this Act.

(i) TREATMENT OF CERTAIN WHOLLY OWNED SUBSIDIARIES.—

* * *

(2) QUALIFIED REIT SUBSIDIARY.—For purposes of this subsection, the term "qualified REIT subsidiary" means any corporation if 100 percent of the stock of such corporation is held by the real estate investment trust.

* * *

Amendment Notes

Act Sec. 1262 amended Code Sec. 856(i)(2) by striking "at all times during the period such corporation was in existence" before the period.

The above amendment applies to tax years beginning after the date of the enactment of this Act.

(j) TREATMENT OF SHARED APPRECIATION MORTGAGES.—

* * *

(4) COORDINATION WITH 4-YEAR HOLDING PERIOD.—

(A) IN GENERAL.—For purposes of section 857(b)(6)(C), if a real estate investment trust is treated as having sold secured property under paragraph (3)(A), the trust shall be treated as having held such property for at least 4 years if—

(i) the secured property is sold or otherwise disposed of pursuant to a case under title 11 of the United States Code,

(ii) the seller is under the jurisdiction of the court in such case, and

(iii) the disposition is required by the court or is pursuant to a plan approved by the court.

(B) EXCEPTION.—Subparagraph (A) shall not apply if—

(i) the secured property was acquired by the seller with the intent to evict or foreclose, or

(ii) the trust knew or had reason to know that default on the obligation described in paragraph (5)(A) would occur.

(5) DEFINITIONS.—For purposes of this subsection—

(A) SHARED APPRECIATION PROVISION.—The term "shared appreciation provision" means any provision—

(i) which is in connection with an obligation which is held by the real estate investment trust and is secured by an interest in real property, and

(ii) which entitles the real estate investment trust to receive a specified portion of any gain realized on the sale or exchange of such real property (or of any gain which would be realized if the property were sold on a specified date) *or appreciation in value as of any specified date.*

(B) SECURED PROPERTY.—The term "secured property" means the real property referred to in subparagraph (A).

Amendment Notes

Act Sec. 1261(a) amended Code Sec. 856(j) by redesignating paragraph (4) as paragraph (5) and by inserting after paragraph (3) a new paragraph (4) to read as above.

Act Sec. 1261(b) amended Code Sec. 856(j)(5)(A)(ii) by inserting before the period "or appreciation in value as of any specified date".

The above amendments apply to tax years beginning after the date of the enactment of this Act.

(k) REQUIREMENT THAT ENTITY NOT BE CLOSELY HELD TREATED AS MET IN CERTAIN CASES.—A corporation, trust, or association—

(1) which for a taxable year meets the requirements of section 857(f)(1), and

(2) which does not know, or exercising reasonable diligence would not have known, whether the entity failed to meet the requirement of subsection (a)(6),

shall be treated as having met the requirement of subsection (a)(6) for the taxable year.

[CCH Explanation at ¶ 539, 541, 543, 547, 551, 553, 559 and 561. Committee Reports at ¶ 12,435, 12,440, 12,445, 12,455, 12,465, 12,470, 12,485 and 12,490.]

Amendment Notes

Act Sec. 1251(b)(1) amended Code Sec. 856 by adding at the end a new subsection (k) to read as above.

The above amendment applies to tax years beginning after the date of the enactment of this Act.

[¶ 5269] CODE SEC. 857. TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND THEIR BENEFICIARIES.

(a) REQUIREMENTS APPLICABLE TO REAL ESTATE INVESTMENT TRUSTS.—The provisions of this part (other than subsection (d) of this section and subsection (g) of section 856) shall not apply to a real estate investment trust for a taxable year unless—

(1) the deduction for dividends paid during the taxable year (as defined in section 561, but determined without regard to capital gains dividends) equals or exceeds—

(A) the sum of—

(i) 95 percent (90 percent for taxable years beginning before January 1, 1980) of the real estate investment trust taxable income for the taxable year (determined without regard to the deduction for dividends paid (as defined in section 561) and by excluding any net capital gain); and

(ii) 95 percent (90 percent for taxable years beginning before January 1, 1980) of the excess of the net income from foreclosure property over the tax imposed on such income by subsection (b)(4)(A); minus

(B) any excess noncash income (as determined under subsection (e));

(2) either—

(A) the provisions of this part apply to the real estate investment trust for all taxable years beginning after February 28, 1986, or

(B) as of the close of the taxable year, the real estate investment trust has no earnings and profits accumulated in any non-REIT year.

For purposes of the preceding sentence, the term "non-REIT year" means any taxable year to which the provisions of this part did not apply with respect to the entity.

The Secretary may waive the requirements of paragraph (1) for any taxable year if the real estate investment trust establishes to the satisfaction of the Secretary that it was unable to meet such requirements by reason of distributions previously made to meet the requirements of section 4981.

Amendment Notes

Act Sec. 1251(a)(1) amended Code Sec. 857(a) by striking paragraph (2) and by redesignating paragraph (3) as paragraph (2). Prior to amendment, Code Sec. 857(a)(2) read as follows:

(2) the real estate investment trust complies for such year with regulations prescribed by the Secretary for the purpose of ascertaining the actual ownership of the outstanding shares, or certificates of beneficial interest, of such trust and

The above amendment applies to tax years beginning after the date of the enactment of this Act.

(b) METHOD OF TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND HOLDERS OF SHARES OR CERTIFICATES OF BENEFICIAL INTEREST.—

* * *

(3) CAPITAL GAINS.—

* * *

(D) TREATMENT BY SHAREHOLDERS OF UNDISTRIBUTED CAPITAL GAINS.—

(i) Every shareholder of a real estate investment trust at the close of the trust's taxable year shall include, in computing his long-term capital gains in his return for his taxable year in which the last day of the trust's taxable year falls, such amount as the trust shall designate in respect of such shares in a written notice mailed to its shareholders at any time prior to the expiration of 60 days after the close of its taxable year (or mailed to its shareholders or holders of beneficial interests with its annual report for the taxable year), but the amount so includible by any shareholder shall not exceed that part of the amount subjected to tax in subparagraph (A)(ii) which he would have received if all of such amount had been distributed as capital gain dividends by the trust to the holders of such shares at the close of its taxable year.

(ii) For purposes of this title, every such shareholder shall be deemed to have paid, for his taxable year under clause (i), the tax imposed by subparagraph (A)(ii) on the amounts required by this subparagraph to be included in respect of such shares in computing his long-term capital gains for that year; and such shareholders shall be allowed credit or refund as the case may be, for the tax so deemed to have been paid by him.

(iii) The adjusted basis of such shares in the hands of the holder shall be increased with respect to the amounts required by this subparagraph to be included in computing his long-term capital gains, by the difference between the amount of such includible gains and the tax deemed paid by such shareholder in respect of such shares under clause (ii).

(iv) In the event of such designation, the tax imposed by subparagraph (A)(ii) shall be paid by the real estate investment trust within 30 days after the close of its taxable year.

(v) The earnings and profits of such real estate investment trust, and the earnings and profits of any such shareholder which is a corporation, shall be appropriately adjusted in accordance with regulations prescribed by the Secretary.

(vi) As used in this subparagraph, the terms "shares" and "shareholders" shall include beneficial interests and holders of beneficial interests, respectively.

(E) COORDINATION WITH NET OPERATING LOSS PROVISIONS.—For purposes of section 172, if a real estate investment trust pays capital gain dividends during any taxable year, the amount of the net capital gain for such taxable year (to the extent such gain does not exceed the amount of such capital gain dividends) shall be excluded in determining—

(i) the net operating loss for the taxable year, and

(ii) the amount of the net operating loss of any prior taxable year which may be carried through such taxable year under section 172(b)(2) to a succeeding taxable year.

* * *

(5) IMPOSITION OF TAX IN CASE OF FAILURE TO MEET CERTAIN REQUIREMENTS.—If *section 856(c)(6)* applies to a real estate investment trust for any taxable year, there is hereby imposed on such trust a tax in an amount equal to the greater of—

* * *

(6) INCOME FROM PROHIBITED TRANSACTIONS.—

* * *

(C) CERTAIN SALES NOT TO CONSTITUTE PROHIBITED TRANSACTIONS.—For purposes of this part, the term "prohibited transaction" does not include a sale of property which is a real estate asset as defined in *section 856(c)(5)(B)* if—

(i) the trust has held the property for not less than 4 years;

(ii) aggregate expenditures made by the trust, or any partner of the trust, during the 4-year period preceding the date of sale which are includible in the basis of the property do not exceed 30 percent of the net selling price of the property;

(iii)(I) during the taxable year the trust does not make more than 7 sales of property *(other than sales of foreclosure property or sales to which section 1033 applies)*, or (II) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property *(other than sales of foreclosure property or sales to which section 1033 applies)* sold during the taxable year does not exceed 10 percent of the aggregate bases (as so determined) of all of the assets of the trust as of the beginning of the taxable year;

(iv) in the case of property, which consists of land or improvements, not acquired through foreclosure (or deed in lieu of foreclosure), or lease termination, the trust has held the property for not less than 4 years for production of rental income; and

(v) if the requirement of clause (iii)(I) is not satisfied, substantially all of the marketing and development expenditures with respect to the property were made through an independent contractor (as defined in section 856(d)(3)) from whom the trust itself does not derive or receive any income.

(7) LOSS ON SALE OR EXCHANGE OF STOCK HELD 6 MONTHS OR LESS.—

(A) IN GENERAL.—If—

(i) *subparagraph (B) or (D)* of paragraph (3) provides that any amount with respect to any share or beneficial interest is to be treated as a long-term capital gain, and

(ii) the taxpayer has held such share or interest for 6 months or less,

then any loss on the sale or exchange of such share or interest shall, to the extent of the amount described in clause (i), be treated as a long-term capital loss.

* * *

Amendment Notes

Act Sec. 1254(a) amended Code Sec. 857(b)(3) by redesignating subparagraph (D) as subparagraph (E) and by inserting after subparagraph (C) a new subparagraph (D) to read as above.

Act Sec. 1254(b)(1) amended Code Sec. 857(b)(7)(A)(i) by striking "subparagraph (B)" and inserting "subparagraph (B) or (D)".

Act Sec. 1255(b)(2) amended Code Sec. 857(b)(5) by striking "section 856(c)(7)" and inserting "section 856(c)(6)".

Act Sec. 1255(b)(3) amended Code Sec. 857(b)(6)(C) by striking "section 856(c)(6)(B)" and inserting "section 856(c)(5)(B)".

Act Sec. 1260 amended Code Sec. 857(b)(6)(C)(iii)(I)-(II) by striking "(other than foreclosure property)" and inserting "(other than sales of foreclosure property or sales to which section 1033 applies)".

The above amendments apply to tax years beginning after the date of the enactment of this Act.

(d) EARNINGS AND PROFITS.—

* * *

(3) DISTRIBUTIONS TO MEET REQUIREMENTS OF SUBSECTION (a)(2)(B).—Any distribution which is made in order to comply with the requirements of subsection (a)(2)(B)—

(A) shall be treated for purposes of this subsection and subsection (a)(2)(B) as made from the earliest accumulated earnings and profits (other than earnings and profits to which subsection (a)(2)(A) applies) rather than the most recently accumulated earnings and profits, and

(B) to the extent treated under subparagraph (A) as made from accumulated earnings and profits, shall not be treated as a distribution for purposes of subsection (b)(2)(B).

Amendment Notes

Act Sec. 1256 amended Code Sec. 857(d) by adding at the end a new paragraph (3) to read as above.

The above amendment applies to tax years beginning after the date of the enactment of this Act.

(e) EXCESS NONCASH INCOME.—

* * *

(2) DETERMINATION OF AMOUNT.—The amount determined under this paragraph for the taxable year is the sum of—

(A) the amount (if any) by which—

(i) the amounts includible in gross income under section 467 (relating to certain payments for the use of property or services), exceed

(ii) the amounts which would have been includible in gross income without regard to such section,

(B) any income on the disposition of a real estate asset if—

(i) there is a determination (as defined in section 860(e)) that such income is not eligible for nonrecognition under section 1031, and

(ii) failure to meet the requirements of section 1031 was due to reasonable cause and not to willful neglect,

(C) the amount (if any) by which—

(i) the amounts includible in gross income with respect to instruments to which section 860E(a) or 1272 applies, exceed

(ii) the amount of money and the fair market value of other property received during the taxable year under such instruments, and

(D) amounts includible in income by reason of cancellation of indebtedness.

Amendment Notes

Act Sec. 1259(1)-(4) amended Code Sec. 857(e)(2)(B)-(D) by striking subparagraph (B), by striking the period at the end of subparagraph (C) and inserting a comma, by redesignating subparagraph (C) (as amended by Act Sec. 1259(2)) as subparagraph (B), and by adding at the end new subparagraphs (C) and (D) to read as above. Prior to amendment, Code Sec. 857(e)(2)(B) read as follows:

(B) in the case of a real estate investment trust using the cash receipts and disbursements method of accounting, the amount (if any) by which—

(i) the amounts includible in gross income with respect to instruments to which section 1274 (relating to certain debt instruments issued for property) applies, exceed

(ii) the amount of money and the fair market value of other property received during the taxable year under such instruments; plus

The above amendment applies to tax years beginning after the date of the enactment of this Act.

(f) REAL ESTATE INVESTMENT TRUSTS TO ASCERTAIN OWNERSHIP.—

(1) IN GENERAL.—Each real estate investment trust shall each taxable year comply with regulations prescribed by the Secretary for the purposes of ascertaining the actual ownership of the outstanding shares, or certificates of beneficial interest, of such trust.

(2) FAILURE TO COMPLY.—

(A) IN GENERAL.—If a real estate investment trust fails to comply with the requirements of paragraph (1) for a taxable year, such trust shall pay (on notice and demand by the Secretary and in the same manner as tax) a penalty of $25,000.

(B) INTENTIONAL DISREGARD.—If any failure under paragraph (1) is due to intentional disregard of the requirement under paragraph (1), the penalty under subparagraph (A) shall be $50,000.

(C) FAILURE TO COMPLY AFTER NOTICE.—The Secretary may require a real estate investment trust to take such actions as the Secretary determines appropriate to ascertain actual ownership if the trust fails to meet the requirements of paragraph (1). If the trust fails to take such actions, the trust shall pay (on notice and demand by the Secretary and in the same manner as tax) an additional penalty equal to the penalty determined under subparagraph (A) or (B), whichever is applicable.

(D) REASONABLE CAUSE.—No penalty shall be imposed under this paragraph with respect to any failure if it is shown that such failure is due to reasonable cause and not to willful neglect.

Amendment Notes

Act Sec. 1251(a)(2) amended Code Sec. 857 by redesignating paragraph (f) as paragraph (g) and by inserting after subsection (e) a new subsection (f) to read as above.

The above amendment applies to tax years beginning after the date of the enactment of this Act.

(g) Cross Reference.—

* * *

[CCH Explanation at ¶ 539, 545, 547, 549, 555 and 557. Committee Reports at ¶ 12,435, 12,450, 12,455, 12,460, 12,475 and 12,480.]

Amendment Notes

Act Sec. 1251(a)(2) amended Code Sec. 857 by redesignating paragraph (f) as paragraph (g).

The above amendment applies to tax years beginning after the date of the enactment of this Act.

[¶ 5271] CODE SEC. 860L. DEFINITIONS AND OTHER SPECIAL RULES.

* * *

(b) Interests in FASIT.—For purposes of this part—

(1) Regular interest.—

(A) In general.—The term "regular interest" means any interest which is issued by a FASIT *on or after the startup date* with fixed terms and which is designated as a regular interest if—

(i) such interest unconditionally entitles the holder to receive a specified principal amount (or other similar amount),

(ii) interest payments (or other similar amounts), if any, with respect to such interest are determined based on a fixed rate, or, except as otherwise provided by the Secretary, at a variable rate permitted under section 860G(a)(1)(B)(i),

(iii) such interest does not have a stated maturity (including options to renew) greater than 30 years (or such longer period as may be permitted by regulations),

(iv) the issue price of such interest does not exceed 125 percent of its stated principal amount, and

(v) the yield to maturity on such interest is less than the sum determined under section 163(i)(1)(B) with respect to such interest.

* * *

Amendment Notes

Act Sec. 1601(f)(6)(A) amended Code Sec. 860L(b)(1)(A) by striking "after the startup date" in the text preceding clause (i) and inserting "on or after the startup date".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective September 1, 1997.—CCH.].

(d) Startup Day.—For purposes of this part—

* * *

(2) Treatment of property held on startup day.—All property held (or treated as held under section *860I(b)(2)*) by an entity as of the startup day shall be treated as contributed to such entity on such day by the holder of the ownership interest in such entity.

Amendment Notes

Act Sec. 1601(f)(6)(B) amended Code Sec. 860L(d)(2) by striking "section 860I(c)(2)" and inserting "section 860I(b)(2)".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective September 1, 1997.—CCH.].

(e) Tax on Prohibited Transactions.—

* * *

(2) Prohibited transactions.—For purposes of this part, the term "prohibited transaction" means—

(A) *except as provided in paragraph (3),* the receipt of any income derived from any asset that is not a permitted asset,

(B) except as provided in paragraph (3), the disposition of any permitted asset *other than foreclosure property,*

(C) the receipt of any income derived from any loan originated by the FASIT, and

(D) the receipt of any income representing a fee or other compensation for services (other than any fee received as compensation for a waiver, amendment, or consent under permitted assets (other than foreclosure property) held by the FASIT).

(3) Exception for income from certain dispositions.—

(A) IN GENERAL.—Paragraph (2)(B) shall not apply to a disposition which would not be a prohibited transaction (as defined in section 860F(a)(2)) by reason of—

(i) clause (ii), (iii), or (iv) of section 860F(a)(2)(A), or

(ii) section 860F(a)(5),

if the FASIT were treated as a REMIC and permitted assets (other than cash or cash equivalents) were treated as qualified mortgages.

* * *

(D) INCOME FROM DISPOSITIONS OF FORMER HEDGE ASSETS.—Paragraph (2)(A) shall not apply to income derived from the disposition of—

(i) an asset which was described in subsection (c)(1)(D) when first acquired by the FASIT but on the date of such disposition was no longer described in subsection (c)(1)(D)(ii), or

(ii) a contract right to acquire an asset described in clause (i).

* * *

[CCH Explanation at ¶ 575. Committee Reports at ¶ 13,670.]

Amendment Notes

Act Sec. 1601(f)(6)(C) amended Code Sec. 860L(e)(2)(B) by inserting "other than foreclosure property" after "any permitted asset".

Act Sec. 1601(f)(6)(D) amended Code Sec. 860L(e)(3)(A) by striking "if the FASIT" and all that follows and inserting new flush text after clause (ii) to read as above. Prior to amendment, Code Sec. 860L(e)(3)(A) read as follows:

(A) IN GENERAL.—Paragraph (2)(B) shall not apply to a disposition which would not be a prohibited transaction (as defined in section 860F(a)(2)) by reason of—

(i) clause (ii), (iii), or (iv) of section 860F(a)(2)(A), or

(ii) section 860F(a)(5), if the FASIT were treated as a REMIC and debt instruments described in subsection (c)(1)(B) were treated as qualified mortgages.

Act Sec. 1601(f)(6)(E)(i) amended Code Sec. 860L(e)(3) by adding at the end a new subparagraph (D) to read as above.

Act Sec. 1601(f)(6)(E)(ii) amended Code Sec. 860L(e)(2)(A) by inserting "except as provided in paragraph (3)," before "the receipt".

The above amendments are effective as if included in the provisions of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which they relate [effective September 1, 1997.—CCH.].

[¶ 5273] CODE SEC. 861. INCOME FROM SOURCES WITHIN THE UNITED STATES.

(a) GROSS INCOME FROM SOURCES WITHIN UNITED STATES.—The following items of gross income shall be treated as income from sources within the United States:

* * *

(3) PERSONAL SERVICES.—Compensation for labor or personal services performed in the United States; except that compensation for labor or services performed in the United States shall not be deemed to be income from sources within the United States if—

(A) the labor or services are performed by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year,

(B) such compensation does not exceed $3,000 in the aggregate, and

(C) the compensation is for labor or services performed as an employee of or under a contract with—

(i) a nonresident alien, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

(ii) an individual who is a citizen or resident of the United States, a domestic partnership, or a domestic corporation, if such labor or services are performed for an office or place of business maintained in a foreign country or in a possession of the United States by such individual, partnership, or corporation.

In addition, except for purposes of sections 79 and 105 and subchapter D, compensation for labor or services performed in the United States shall not be deemed to be income from sources within the United States if the labor or services are performed by a nonresident alien individual in connection with the individual's temporary presence in the United States as a regular member of the crew of a foreign vessel engaged in transportation between the United States and a foreign country or a possession of the United States.

* * *

[CCH Explanation at ¶ 965. Committee Reports at ¶ 11,880.]

Amendment Notes

Act Sec. 1174(a)(1) amended Code Sec. 861(a)(3) by adding at the end a new flush sentence to read as above.

The above amendment applies to remuneration for services performed in tax years beginning after December 31, 1997.

[¶ 5275] CODE SEC. 863. SPECIAL RULES FOR DETERMINING SOURCE.

* * *

(c) SOURCE RULE FOR CERTAIN TRANSPORTATION INCOME.—

* * *

(2) OTHER TRANSPORTATION HAVING UNITED STATES CONNECTION.—

* * *

(B) SPECIAL RULE FOR PERSONAL SERVICE INCOME.—Subparagraph (A) shall not apply to any transportation income which is income derived from personal services performed by the taxpayer, unless such income is attributable to transportation which—

(i) begins in the United States and ends in a possession of the United States, or

(ii) begins in a possession of the United States and ends in the United States.

In the case of transportation income derived from, or in connection with, a vessel, this subparagraph shall only apply if the taxpayer is a citizen or resident alien.

* * *

[CCH Explanation at ¶ 965. Committee Reports at ¶ 11,880.]

Amendment Notes

Act Sec. 1174(a)(2) amended Code Sec. 863(c)(2)(B) by adding at the end a new flush sentence to read as above.

The above amendment applies to remuneration for services performed in tax years beginning after December 31, 1997.

[¶ 5277] CODE SEC. 864. DEFINITIONS AND SPECIAL RULES.

* * *

(b) TRADE OR BUSINESS WITHIN THE UNITED STATES.—For purposes of this part, part II, and chapter 3, the term "trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year, but does not include—

* * *

(2) TRADING IN SECURITIES OR COMMODITIES.—

(A) STOCKS AND SECURITIES.—

* * *

(ii) TRADING FOR TAXPAYER'S OWN ACCOUNT.—Trading in stocks or securities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such employee or agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a dealer in stocks or securities.

* * *

[CCH Explanation at ¶ 955. Committee Reports at ¶ 11,840.]

Amendment Notes

Act Sec. 1162(a) amended Code Sec. 864(b)(2)(A)(ii) by striking ", or in the case of a corporation" and all that follows in the last sentence and inserting a period. Prior to amendment, the last sentence of Code Sec. 864(b)(2)(A)(ii) read as follows:

This clause shall not apply in the case of a dealer in stocks or securities, or in the case of a corporation (other than a corporation which is, or but for section 542(c)(7), 542(c)(10), or 543(b)(1)(C) would be, a personal holding company) the principal business of which is trading in stocks or securities for its own account, if its principal office is in the United States.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5279] CODE SEC. 877. EXPATRIATION TO AVOID TAX.

* * *

(d) SPECIAL RULES FOR SOURCE, ETC.—For purposes of subsection (b)—

* * *

(2) GAIN RECOGNITION ON CERTAIN EXCHANGES.—

* * *

(B) EXCHANGES TO WHICH PARAGRAPH APPLIES.—This paragraph shall apply to any exchange during *the 10-year period beginning on the date the individual loses United States citizenship* if—

(i) gain would not (but for this paragraph) be recognized on such exchange in whole or in part for purposes of this subtitle,

(ii) income derived from such property was from sources within the United States (or, if no income was so derived, would have been from such sources), and

(iii) income derived from the property acquired in the exchange would be from sources outside the United States.

* * *

(D) SECRETARY MAY EXTEND PERIOD.—To the extent provided in regulations prescribed by the Secretary, subparagraph (B) shall be applied by substituting the 15-year period beginning 5 years before the loss of United States citizenship for the 10-year period referred to therein. *In the case of any exchange occurring during such 5 years, any gain recognized under this subparagraph shall be recognized immediately after such loss of citizenship.*

* * *

(3) SUBSTANTIAL DIMINISHING OF RISKS OF OWNERSHIP.—For purposes of determining whether this section applies to any gain on the sale or exchange of any property, the running of the 10-year period described in subsection (a) *and the period applicable under paragraph (2)* shall be suspended for any period during which the individual's risk of loss with respect to the property is substantially diminished by—

(A) the holding of a put with respect to such property (or similar property),

(B) the holding by another person of a right to acquire the property, or

(C) a short sale or any other transaction.

(4) TREATMENT OF PROPERTY CONTRIBUTED TO CONTROLLED FOREIGN CORPORATIONS.—

(A) IN GENERAL.—If—

(i) an individual losing United States citizenship contributes property *during the 10-year period beginning on the date the individual loses United States citizenship* to any corporation which, at the time of the contribution, is described in subparagraph (B), and

(ii) income derived from such property *immediately before such contribution* was from sources within the United States (or, if no income was so derived, would have been from such sources),

any income or gain on such property (or any other property which has a basis determined in whole or part by reference to such property) received or accrued by the corporation shall be treated as received or accrued directly by such individual and not by such corporation. The preceding sentence shall not apply to the extent the property has been treated under subparagraph (C) as having been sold by such corporation.

* * *

Amendment Notes

Act Sec. 1602(g)(1) amended Code Sec. 877(d)(2)(B) by striking "the 10-year period described in subsection (a)" and inserting "the 10-year period beginning on the date the individual loses United States citizenship".

Act Sec. 1602(g)(2) amended Code Sec. 877(d)(2)(D) by adding at the end a new sentence to read as above.

Act Sec. 1602(g)(3) amended Code Sec. 877(d)(3) by inserting "and the period applicable under paragraph (2)" after "subsection (a)".

Act Sec. 1602(g)(4)(A)-(C) amended Code Sec. 877(d)(4)(A) by inserting "during the 10-year period beginning on the date the individual loses United States citizenship" after "contributes property" in clause (i), by inserting "immediately before such contribution" after "from such property", and by striking "during the 10-year period referred to in subsection (a)," at the beginning of the flush left material.

The above amendments are effective as if included in the provisions of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which they relate [generally effective for individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995.—CCH.].

(e) COMPARABLE TREATMENT OF LAWFUL PERMANENT RESIDENTS WHO CEASE TO BE TAXED AS RESIDENTS.—

(1) IN GENERAL.—Any long-term resident of the United States who—

(A) ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6)), or

(B) commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country and who does not waive the benefits of such treaty applicable to residents of the foreign country,

shall be treated for purposes of this section and sections 2107, 2501, and *6039G* in the same manner as if such resident were a citizen of the United States who lost United States citizenship on the date of such cessation or commencement.

* * *

[CCH Explanation at ¶ 926, 928 and 929. Committee Reports at ¶ 13,875, 13,880, 13,885 and 13,890.]

Amendment Notes

Act Sec. 1602(h)(3) amended Code Sec. 877(e)(1) by striking "6039F" and inserting "6039G".

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which it relates [generally effective for individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995.—CCH.].

[¶ 5281] CODE SEC. 894. INCOME AFFECTED BY TREATY.

* * *

(c) Denial of Treaty Benefits for Certain Payments Through Hybrid Entities.—

(1) Application to certain payments.—A foreign person shall not be entitled under any income tax treaty of the United States with a foreign country to any reduced rate of any withholding tax imposed by this title on an item of income derived through an entity which is treated as a partnership (or is otherwise treated as fiscally transparent) for purposes of this title if—

(A) such item is not treated for purposes of the taxation laws of such foreign country as an item of income of such person,

(B) the treaty does not contain a provision addressing the applicability of the treaty in the case of an item of income derived through a partnership, and

(C) the foreign country does not impose tax on a distribution of such item of income from such entity to such person.

(2) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate to determine the extent to which a taxpayer to which paragraph (1) does not apply shall not be entitled to benefits under any income tax treaty of the United States with respect to any payment received by, or income attributable to any activities of, an entity organized in any jurisdiction (including the United States) that is treated as a partnership or is otherwise treated as fiscally transparent for purposes of this title (including a common investment trust under section 584, a grantor trust, or an entity that is disregarded for purposes of this title) and is treated as fiscally nontransparent for purposes of the tax laws of the jurisdiction of residence of the taxpayer.

* * *

[CCH Explanation at ¶ 992. Committee Reports at ¶ 11,380.]

Amendment Notes

Act Sec. 1054(a) amended Code Sec. 894 by inserting after subsection (b) a new subsection (c) to read as above.

The above amendment applies upon the date of the enactment of this Act.

[¶ 5283] CODE SEC. 901. TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES.

* * *

(k) Minimum Holding Period for Certain Taxes.—

(1) Withholding taxes.—

(A) In general.—In no event shall a credit be allowed under subsection (a) for any withholding tax on a dividend with respect to stock in a corporation if—

(i) such stock is held by the recipient of the dividend for 15 days or less during the 30-day period beginning on the date which is 15 days before the date on which such share becomes ex-dividend with respect to such dividend, or

(ii) to the extent that the recipient of the dividend is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

(B) WITHHOLDING TAX.—For purposes of this paragraph, the term "withholding tax" includes any tax determined on a gross basis; but does not include any tax which is in the nature of a prepayment of a tax imposed on a net basis.

(2) DEEMED PAID TAXES.—In the case of income, war profits, or excess profits taxes deemed paid under section 853, 902, or 960 through a chain of ownership of stock in 1 or more corporations, no credit shall be allowed under subsection (a) for such taxes if—

(A) any stock of any corporation in such chain (the ownership of which is required to obtain credit under subsection (a) for such taxes) is held for less than the period described in paragraph (1)(A)(i), or

(B) the corporation holding the stock is under an obligation referred to in paragraph (1)(A)(ii).

(3) 45-DAY RULE IN THE CASE OF CERTAIN PREFERENCE DIVIDENDS.—In the case of stock having preference in dividends and dividends with respect to such stock which are attributable to a period or periods aggregating in excess of 366 days, paragraph (1)(A)(i) shall be applied—

(A) by substituting "45 days" for "15 days" each place it appears, and

(B) by substituting "90-day period" for "30-day period".

(4) EXCEPTION FOR CERTAIN TAXES PAID BY SECURITIES DEALERS.—

(A) IN GENERAL.—Paragraphs (1) and (2) shall not apply to any qualified tax with respect to any security held in the active conduct in a foreign country of a securities business of any person—

(i) who is registered as a securities broker or dealer under section 15(a) of the Securities Exchange Act of 1934,

(ii) who is registered as a Government securities broker or dealer under section 15C(a) of such Act, or

(iii) who is licensed or authorized in such foreign country to conduct securities activities in such country and is subject to bona fide regulation by a securities regulating authority of such country.

(B) QUALIFIED TAX.—For purposes of subparagraph (A), the term "qualified tax" means a tax paid to a foreign country (other than the foreign country referred to in subparagraph (A)) if—

(i) the dividend to which such tax is attributable is subject to taxation on a net basis by the country referred to in subparagraph (A), and

(ii) such country allows a credit against its net basis tax for the full amount of the tax paid to such other foreign country.

(C) REGULATIONS.—The Secretary may prescribe such regulations as may be appropriate to carry out this paragraph, including regulations to prevent the abuse of the exception provided by this paragraph and to treat other taxes as qualified taxes.

(5) CERTAIN RULES TO APPLY.—For purposes of this subsection, the rules of paragraphs (3) and (4) of section 246(c) shall apply.

(6) TREATMENT OF BONA FIDE SALES.—If a person's holding period is reduced by reason of the application of the rules of section 246(c)(4) to any contract for the bona fide sale of stock, the determination of whether such person's holding period meets the requirements of paragraph (2) with respect to taxes deemed paid under section 902 or 960 shall be made as of the date such contract is entered into.

(7) TAXES ALLOWED AS DEDUCTION, ETC.—Sections 275 and 78 shall not apply to any tax which is not allowable as a credit under subsection (a) by reason of this subsection.

Amendment Notes

Act Sec. 1053(a) amended Code Sec. 901 by redesignating subsection (k) as subsection (l) and by inserting after subsection (j) a new subsection (k) to read as above.

The above amendment applies to dividends paid or accrued more than 30 days after the date of the enactment of this Act.

(l) CROSS REFERENCE.—

(1) For deductions of income, war profits, and excess profits taxes paid to a foreign country or a possession of the United States, see sections 164 and 275.

(2) For right of each partner to make election under this section, see section 703(b).

(3) For right of estate or trust to the credit for taxes imposed by foreign countries and possessions of the United States under this section, see section 642(a).

(4) For reduction of credit for failure of a United States person to furnish certain information with respect to a *foreign corporation or partnership* controlled by him, see section 6038.

[CCH Explanation at ¶ 917 and 983. Committee Reports at ¶ 11,375 and 11,760.]

Amendment Notes

Act Sec. 1053(a) amended Code Sec. 901 by redesignating subsection (k) as subsection (l).

The above amendment applies to dividends paid or accrued more than 30 days after the date of the enactment of this Act.

Act Sec. 1142(e)(4) amended Code Sec. 901(k)[l](4) by striking "foreign corporation" and inserting "foreign corporation or partnership".

The above amendment applies to annual accounting periods beginning after the date of the enactment of this Act.

[¶ 5285] CODE SEC. 902. DEEMED PAID CREDIT WHERE DOMESTIC CORPORATION OWNS 10 PERCENT OR MORE OF VOTING STOCK OF FOREIGN CORPORATION.

* * *

(b) DEEMED TAXES INCREASED IN CASE OF CERTAIN LOWER TIER CORPORATIONS.—

(1) IN GENERAL.—If—

(A) any foreign corporation is a member of a qualified group, and

(B) such foreign corporation owns 10 percent or more of the voting stock of another member of such group from which it receives dividends in any taxable year,

such foreign corporation shall be deemed to have paid the same proportion of such other member's post-1986 foreign income taxes as would be determined under subsection (a) if such foreign corporation were a domestic corporation.

(2) QUALIFIED GROUP.—For purposes of paragraph (1), the term "qualified group" means—

(A) the foreign corporation described in subsection (a), and

(B) any other foreign corporation if—

(i) the domestic corporation owns at least 5 percent of the voting stock of such other foreign corporation indirectly through a chain of foreign corporations connected through stock ownership of at least 10 percent of their voting stock,

(ii) the foreign corporation described in subsection (a) is the first tier corporation in such chain, and

(iii) such other corporation is not below the sixth tier in such chain.

The term "qualified group" shall not include any foreign corporation below the third tier in the chain referred to in clause (i) unless such foreign corporation is a controlled foreign corporation (as defined in section 957) and the domestic corporation is a United States shareholder (as defined in section 951(b)) in such foreign corporation. Paragraph (1) shall apply to those taxes paid by a member of the qualified group below the third tier only with respect to periods during which it was a controlled foreign corporation.

Amendment Notes

Act Sec. 1113(a)(1) amended Code Sec. 902(b) to read as above. Prior to amendment, Code Sec. 902(b) read as follows:

(b) DEEMED TAXES INCREASED IN CASE OF CERTAIN 2ND AND 3RD TIER FOREIGN CORPORATIONS.—

(1) 2ND TIER.—If the foreign corporation described in subsection (a) (hereinafter in this section referred to as the "1st tier corporation") owns 10 percent or more of the voting stock of a 2nd foreign corporation from which it receives dividends in any taxable year, the 1st tier corporation shall be deemed to have paid the same proportion of such 2nd foreign corporation's post-1986 foreign income taxes as would be determined under subsection (a) if such 1st tier corporation were a domestic corporation.

(2) 3RD TIER.—If such 1st tier corporation owns 10 percent or more of the voting stock of a 2nd foreign corporation which, in turn, owns 10 percent or more of the voting stock of a 3rd foreign corporation from which the 2nd corporation receives dividends in any taxable year, such 2nd foreign corporation shall be deemed to have paid the same proportion of such 3rd foreign corporation's post-1986 foreign income taxes as would be determined under subsection (a) if such 2nd foreign corporation were a domestic corporation.

(3) 5 PERCENT STOCK REQUIREMENT.—For purposes of this subpart—

(A) FOR 2ND TIER.—Paragraph (1) shall not apply unless the percentage of voting stock owned by the domestic corporation in the 1st tier corporation and the percentage of voting stock owned by the 1st tier corporation in the 2nd foreign corporation when multiplied together equal at least 5 percent.

(B) FOR 3RD TIER.—Paragraph (2) shall not apply unless the percentage arrived at for purposes of applying paragraph (1) when multiplied by the percentage of voting stock owned by the 2nd foreign corporation in the 3rd foreign corporation is equal to at least 5 percent.

The above amendment generally applies to taxes of foreign corporations for tax years of such corporations beginning after the date of enactment of this Act. For a special rule, see Act Sec. 1113(c)(2), below.

Act Sec. 1113(c)(2) provides:

(2) SPECIAL RULE.—In the case of any chain of foreign corporations described in clauses (i) and (ii) of section 902(b)(2)(B) of the Internal Revenue Code of 1986 (as amended by this section), no liquidation, reorganization, or similar transaction in a taxable year beginning after the date of the enactment of this Act shall have the effect of permit-

ting taxes to be taken into account under section 902 of the Internal Revenue Code of 1986 which could not have been taken into account under such section but for such transaction.

(c) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

* * *

(2) POST-1986 FOREIGN INCOME TAXES.—The term "post-1986 foreign income taxes" means the sum of—

(A) the foreign income taxes with respect to the taxable year of the foreign corporation in which the dividend is distributed, and

(B) the foreign income taxes with respect to prior taxable years beginning after December 31, 1986, to the extent such foreign taxes were not *attributable to* dividends distributed by the foreign corporation in prior taxable years.

(3) SPECIAL RULE *WHERE FOREIGN CORPORATION FIRST QUALIFIES* AFTER DECEMBER 31, 1986.—

(A) IN GENERAL.—If the 1st day on which the requirements of subparagraph (B) are met with respect to any foreign corporation is in a taxable year of such corporation beginning after December 31, 1986, the post-1986 undistributed earnings and the post-1986 foreign income taxes of such foreign corporation shall be determined by taking into account only periods beginning on and after the 1st day of the 1st taxable year in which such ownership are met.

(B) REQUIREMENTS.—The requirements of this subparagraph are met with respect to any foreign corporation if—

(i) 10 percent of more of the voting stock of such foreign corporation is owned by a domestic corporation, *or*

(ii) the requirements of subsection (b)(2) are met with respect to such foreign corporation.

(4) FOREIGN INCOME TAXES.—

* * *

(B) TREATMENT OF DEEMED TAXES.—Except for purposes of determining the amount of the post-1986 foreign income taxes of a *sixth tier foreign corporation* referred to in subsection (b)(2), the term "foreign income taxes" includes any such taxes deemed to be paid by the foreign corporation under this section.

* * *

[CCH Explanation at ¶ 934. Committee Reports at ¶ 11,665 and 11,845.]

Amendment Notes

Act Sec. 1113(a)(2)(A) amended Code Sec. 902(c)(3)(B) by adding "or" at the end of clause (i) and by striking clauses (ii) and (iii) and inserting a new clause (ii) to read as above. Prior to amendment, Code Sec. 902(c)(3)(B)(ii)-(iii) read as follows:

(ii) the requirements of subsection (b)(3)(A) are met with respect to such foreign corporation and 10 percent or more of the voting stock of such foreign corporation is owned by another foreign corporation described in clause (i), or

(iii) the requirements of subsection (b)(3)(B) are met with respect to such foreign corporation and 10 percent or more of the voting stock of such foreign corporation is owned by another foreign corporation described in clause (ii).

Act Sec. 1113(a)(2)(B) amended Code Sec. 902(c)(4)(B) by striking "3rd foreign corporation" and inserting "sixth tier foreign corporation".

Act Sec. 1113(a)(2)(C) amended Code Sec. 902(c)(3) by striking "WHERE DOMESTIC CORPORATION ACQUIRES 10 PERCENT OF FOREIGN CORPORATION" in the heading and inserting "WHERE FOREIGN CORPORATION FIRST QUALIFIES".

Act Sec. 1113(a)(2)(D) amended Code Sec. 902(c)(3) by striking "ownership" each place it appears. Prior to amendment, Code Sec. 902(c)(3) read as follows:

(3) SPECIAL RULE WHERE DOMESTIC CORPORATION ACQUIRES 10 PERCENT OF FOREIGN CORPORATION AFTER DECEMBER 31, 1986.—

(A) IN GENERAL.—If the 1st day on which the ownership requirements of subparagraph (B) are met with respect to any foreign corporation is in a taxable year of such corporation beginning after December 31, 1986, the post-1986 undistributed earnings and the post-1986 foreign income taxes of such foreign corporation shall be determined by taking into account only periods beginning on and after the 1st day of the 1st taxable year in which such ownership requirements are met.

(B) OWNERSHIP REQUIREMENTS.—The ownership requirements of this subparagraph are met with respect to any foreign corporation if—

(i) 10 percent of more of the voting stock of such foreign corporation is owned by a domestic corporation,

(ii) the requirements of subsection (b)(3)(A) are met with respect to such foreign corporation and 10 percent or more of the voting stock of such foreign corporation is owned by another foreign corporation described in clause (i), or

(iii) the requirements of subsection (b)(3)(B) are met with respect to such foreign corporation and 10 percent or more of the voting stock of such foreign corporation is owned by another foreign corporation described in clause (ii).

The above amendments generally apply to taxes of foreign corporations for tax years of such corporations beginning after the date of enactment of this Act. For a special rule, see Act Sec. 1113(c)(2), below.

Act Sec. 1113(c)(2) provides:

(2) SPECIAL RULE.—In the case of any chain of foreign corporations described in clauses (i) and (ii) of section 902(b)(2)(B) of the Internal Revenue Code of 1986 (as amended by this section), no liquidation, reorganization, or similar transaction in a taxable year beginning after the date of the enactment of this Act shall have the effect of permit-

ting taxes to be taken into account under section 902 of the Internal Revenue Code of 1986 which could not have been taken into account under such section but for such transaction.

Act Sec. 1163(a) amended Code Sec. 902(c)(2)(B) by striking "deemed paid with respect to" and inserting "attributable to".

The above amendment is effective on the date of the enactment of this Act.

[¶ 5287] CODE SEC. 904. LIMITATION ON CREDIT.

* * *

(b) TAXABLE INCOME FOR PURPOSE OF COMPUTING LIMITATION.—

* * *

(2) CAPITAL GAINS.—For purposes of this section—

* * *

(C) COORDINATION WITH CAPITAL GAINS RATES.—The Secretary may by regulations modify the application of this paragraph and paragraph (3) to the extent necessary to properly reflect any capital gain rate differential under section 1(h) or 1201(a) and the computation of net capital gain.

* * *

Amendment Notes

Act Sec. 311(c)(3) amended Code Sec. 904(b)(2) by adding at the end a new subparagraph (C) to read as above.

The above amendment applies to tax years ending after May 6, 1997.

(d) SEPARATE APPLICATION OF SECTION WITH RESPECT TO CERTAIN CATEGORIES OF INCOME.—

(1) IN GENERAL.—The provisions of subsections (a), (b), and (c) and sections 902, 907, and 960 shall be applied separately with respect to each of the following items of income:

(A) passive income,

(B) high withholding tax interest,

(C) financial services income,

(D) shipping income,

[Caution: Code Sec. 904(d)(1)(E), below, as amended by Act Sec. 1105(a)(1) of the Taxpayer Relief Act of 1997, applies to tax years beginning after December 31, 2002.—CCH.]

(E) in the case of a corporation, dividends from noncontrolled section 902 corporations out of earnings and profits accumulated in taxable years beginning before January 1, 2003,

(F) dividends from a DISC or former DISC (as defined in section 992(a)) to the extent such dividends are treated as income from sources without the United States,

(G) taxable income attributable to foreign trade income (within the meaning of section 923(b)),

(H) distributions from a FSC (or former FSC) out of earnings and profits attributable to foreign trade income (within the meaning of section 923(b) or interest or carrying charges (as defined in section 927(d)(1)) derived from a transaction which results in foreign trade income (as defined in section 923(b)), and

(I) income other than income described in any of the preceding subparagraphs.

(2) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

* * *

(C) FINANCIAL SERVICES INCOME.—

(i) IN GENERAL.—Except as otherwise provided in this subparagraph, the term "financial services income" means any income which is received or accrued by any person predominantly engaged in the active conduct of a banking, insurance, financing, or similar business, and which is—

(I) described in clause (ii),

(II) passive income (determined without regard to *subclauses (I) and (III)* of subparagraph (A)(iii)), or

(III) export financing interest which (but for subparagraph (B)(ii)) would be high withholding tax interest.

* * *

(iii) EXCEPTIONS.—The term "financial services income" does not include—

(I) any high withholding tax interest,

[*Caution: Code Sec. 904(d)(2)(C)(iii)(II), below, as amended by Act Sec. 1105(a)(3) of the Taxpayer Relief Act of 1997, applies to tax years beginning after December 31, 2002.—CCH.*]

(II) any dividend from a noncontrolled section 902 corporation *out of earnings and profits accumulated in taxable years beginning before January 1, 2003,* and

(III) any export financing interest not described in clause (i)(III).

[*Caution: Code Sec. 904(d)(2)(D), below, as amended by Act Sec. 1105(a)(3) of the Taxpayer Relief Act of 1997, applies to tax years beginning after December 31, 2002.—CCH.*]

(D) SHIPPING INCOME.—The term "shipping income" means any income received or accrued by any person which is of a kind which would be foreign base company shipping income (as defined in section 954(f)). Such term does not include any dividend from a noncontrolled section 902 corporation *out of earnings and profits accumulated in taxable years beginning before January 1, 2003* and does not include any financial services income.

(E) NONCONTROLLED SECTION 902 CORPORATION.—

(i) IN GENERAL.—The term "noncontrolled section 902 corporation" means any foreign corporation with respect to which the taxpayer meets the stock ownership requirements of section 902(a) (or, for purposes of applying paragraph (3), the requirements of section 902(b)). A controlled foreign corporation shall not be treated as a noncontrolled section 902 corporation with respect to any distribution out of its earnings and profits for periods during which it was a controlled foreign corporation.

* * *

[*Caution: Code Sec. 904(d)(2)(E)(iv), below, as added by Act Sec. 1105(a)(2) of the Taxpayer Relief Act of 1997, applies to tax years beginning after December 31, 2002.—CCH.*]

(iv) ALL NON-PFICs TREATED AS ONE.—All noncontrolled section 902 corporations which are not passive foreign investment companies (as defined in section 1297) shall be treated as one noncontrolled section 902 corporation for purposes of paragraph (1).

* * *

[*Caution: Code Sec. 904(d)(4), below, as added by Act Sec. 1105(b) of the Taxpayer Relief Act of 1997, applies to tax years beginning after December 31, 2002. —CCH.*]

(4) LOOK-THRU APPLIES TO DIVIDENDS FROM NONCONTROLLED SECTION 902 CORPORATIONS.—

(A) IN GENERAL.—For purposes of this subsection, any applicable dividend shall be treated as income in a separate category in proportion to the ratio of—

(i) the portion of the earnings and profits described in subparagraph (B)(ii) attributable to income in such category, to

(ii) the total amount of such earnings and profits.

(B) APPLICABLE DIVIDEND.—For purposes of subparagraph (A), the term "applicable dividend" means any dividend—

(i) from a noncontrolled section 902 corporation with respect to the taxpayer, and

(ii) paid out of earnings and profits accumulated in taxable years beginning after December 31, 2002.

(C) Special rules.—

(i) In general.—Rules similar to the rules of paragraph (3)(F) shall apply for purposes of this paragraph.

(ii) Earnings and profits.—For purposes of this paragraph and paragraph (1)(E)—

(I) In general.—The rules of section 316 shall apply.

(II) Regulations.—The Secretary may prescribe regulations regarding the treatment of distributions out of earnings and profits for periods prior to the taxpayer's acquisition of such stock.

(5) Controlled foreign corporation; United States shareholder.—For purposes of this subsection—

* * *

(6) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate for the purposes of this subsection, including regulations—

* * *

Amendment Notes

Act Sec. 1105(a)(1) amended Code Sec. 904(d)(1)(E) to read as above. Prior to amendment, Code Sec. 904(d)(1)(E) read as follows:

(E) in a case of a corporation, dividends from each noncontrolled section 902 corporation,

Act Sec. 1105(a)(2) amended Code Sec. 904(d)(2)(E) by adding at the end a new clause (iv) to read as above.

Act Sec. 1105(a)(3) amended Code Sec. 904(d)(2)(C)(iii)(II) and (D) by inserting "out of earnings and profits accumulated in taxable years beginning before January 1, 2003" after "corporation".

Act Sec. 1105(b) amended Code Sec. 904(d) by redesignating paragraphs (4) and (5) as paragraphs (5) and (6), respectively, and by inserting after paragraph (3) a new paragraph (4) to read as above.

The above amendments apply to tax years beginning after December 31, 2002.

Act Sec. 1111(b) amended Code Sec. 904(d)(2)(E)(i) by striking "and except as provided in regulations, the taxpayer was a United States shareholder in such corporation" before the period in the second sentence.

The above amendment applies to distributions after the date of the enactment of this Act.

Act Sec. 1163(b) amended Code Sec. 904(d)(2)(C)(i)(II) by striking "subclause (I)" and inserting "subclauses (I) and (III)".

The above amendment is effective on the date of the enactment of this Act.

(j) Certain Individuals Exempt.—

(1) In general.—In the case of an individual to whom this subsection applies for any taxable year—

(A) the limitation of subsection (a) shall not apply,

(B) no taxes paid or accrued by the individual during such taxable year may be deemed paid or accrued under subsection (c) in any other taxable year, and

(C) no taxes paid or accrued by the individual during any other taxable year may be deemed paid or accrued under subsection (c) in such taxable year.

(2) Individuals to whom subsection applies.—This subsection shall apply to an individual for any taxable year if—

(A) the entire amount of such individual's gross income for the taxable year from sources without the United States consists of qualified passive income,

(B) the amount of the creditable foreign taxes paid or accrued by the individual during the taxable year does not exceed $300 ($600 in the case of a joint return), and

(C) such individual elects to have this subsection apply for the taxable year.

(3) Definitions.—For purposes of this subsection—

(A) Qualified passive income.—The term "qualified passive income" means any item of gross income if—

(i) such item of income is passive income (as defined in subsection (d)(2)(A) without regard to clause (iii) thereof), and

(ii) such item of income is shown on a payee statement furnished to the individual.

(B) Creditable foreign taxes.—The term "creditable foreign taxes" means any taxes for which a credit is allowable under section 901; except that such term shall not include any tax unless such tax is shown on a payee statement furnished to such individual.

(C) Payee statement.—The term "payee statement" has the meaning given to such term by section 6724(d)(2).

(D) Estates and trusts not eligible.—This subsection shall not apply to any estate or trust.

Amendment Notes

Act Sec. 1101(a) amended Code Sec. 904 by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) a new subsection (j) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

(k) Cross References.—

* * *

[CCH Explanation at ¶ 303, 904, 912, 915 and 932. Committee Reports at ¶ 10,295, 11,615, 11,635, 11,655 and 11,850.]

Amendment Notes

Act Sec. 1101(a) amended Code Sec. 904 by redesignating subsection (j) as subsection (k).

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5289] CODE SEC. 905. APPLICABLE RULES.

* * *

(c) Adjustments to Accrued Taxes.—

(1) In general.—If—

(A) accrued taxes when paid differ from the amounts claimed as credits by the taxpayer,

(B) accrued taxes are not paid before the date 2 years after the close of the taxable year to which such taxes relate, or

(C) any tax paid is refunded in whole or in part,

the taxpayer shall notify the Secretary, who shall redetermine the amount of the tax for the year or years affected. The Secretary may prescribe adjustments to the pools of post-1986 foreign income taxes and the pools of post-1986 undistributed earnings under sections 902 and 960 in lieu of the redetermination under the preceding sentence.

(2) Special rule for taxes not paid within 2 years.—

(A) In general.—Except as provided in subparagraph (B), in making the redetermination under paragraph (1), no credit shall be allowed for accrued taxes not paid before the date referred to in subparagraph (B) of paragraph (1).

(B) Taxes subsequently paid.—Any such taxes if subsequently paid—

(i) shall be taken into account—

(I) in the case of taxes deemed paid under section 902 or section 960, for the taxable year in which paid (and no redetermination shall be made under this section by reason of such payment), and

(II) in any other case, for the taxable year to which such taxes relate, and

(ii) shall be translated as provided in section 986(a)(2)(A).

(3) Adjustments.—The amount of tax (if any) due on any redetermination under paragraph (1) shall be paid by the taxpayer on notice and demand by the Secretary, and the amount of tax overpaid (if any) shall be credited or refunded to the taxpayer in accordance with subchapter B of chapter 66 (section 6511 et seq.).

(4) Bond requirements.—In the case of any tax accrued but not paid, the Secretary, as a condition precedent to the allowance of the credit provided in this subpart, may require the taxpayer to give a bond, with sureties satisfactory to and approved by the Secretary, in such sum as the Secretary may require, conditioned on the payment by the taxpayer of any amount of tax found due on any such redetermination. Any such bond shall contain such further conditions as the Secretary may require.

(5) Other special rules.—In any redetermination under paragraph (1) by the Secretary of the amount of tax due from the taxpayer for the year or years affected by a refund, the amount of the taxes refunded for which credit has been allowed under this section shall be reduced by the amount of any tax described in section 901 imposed by the foreign country or possession of the United States with respect to such refund; but no credit under this subpart, or deduction under section 164, shall be allowed for any taxable year with respect to any such tax imposed on the refund. No interest shall be assessed or collected on any amount of tax due on any redetermination by the Secretary, resulting from a refund to the taxpayer, for any period before the receipt of such refund, except to the extent

interest was paid by the foreign country or possession of the United States on such refund for such period.

* * *

[CCH Explanation at ¶ 901. Committee Reports at ¶ 11,620.]

Amendment Notes

Act Sec. 1102(a)(2) amended Code Sec. 905(c) to read as above. Prior to amendment, Code Sec. 905(c) read as follows:

(c) ADJUSTMENTS ON PAYMENT OF ACCRUED TAXES.—If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Secretary, who shall redetermine the amount of the tax for the year or years affected. The amount of tax due on such redetermination, if any, shall be paid by the taxpayer on notice and demand by the Secretary, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with subchapter B of chapter 66 (sec. 6511 and following). In the case of such a tax accrued but not paid, the Secretary, as a condition precedent to the allowance of this credit, may require the taxpayer to give a bond, with sureties satisfactory to and to be approved by the Secretary, in such sum as the Secretary may require, conditioned on the payment by the taxpayer of any amount of tax found due on any such redetermination; and the bond herein prescribed shall contain such further conditions as the Secretary may require. In such redetermination by the Secretary of the amount of tax due from the taxpayer for the year or years affected by a refund, the amount of the taxes refunded for which credit has been allowed under this section shall be reduced by the amount of any tax described in section 901 imposed by the foreign country or possession of the United States with respect to such refund; but no credit under this subpart, and no deduction under section 164 (relating to deduction for taxes) shall be allowed for any taxable year with respect to such tax imposed on the refund. No interest shall be assessed or collected on any amount of tax due on any redetermination by the Secretary, resulting from a refund to the taxpayer, for any period before the receipt of such refund, except to the extent interest was paid by the foreign country or possession of the United States on such refund for such period.

The above amendment applies to taxes which relate to tax years beginning after December 31, 1997.

[¶ 5291] CODE SEC. 911. CITIZENS OR RESIDENTS OF THE UNITED STATES LIVING ABROAD.

* * *

(b) FOREIGN EARNED INCOME.—

* * *

(2) LIMITATION ON FOREIGN EARNED INCOME.—

(A) IN GENERAL.—The foreign earned income of an individual which may be excluded under subsection (a)(1) for any taxable year shall not exceed the amount of foreign earned income computed on a daily basis at an annual rate *equal to the exclusion amount for the calendar year in which such taxable year begins.*

* * *

(D) EXCLUSION AMOUNT.—

(i) IN GENERAL.—The exclusion amount for any calendar year is the exclusion amount determined in accordance with the following table (as adjusted by clause (ii)):

For calendar year—	*The exclusion amount is—*
1998	*$72,000*
1999	*74,000*
2000	*76,000*
2001	*78,000*
2002 and thereafter	*80,000*

(ii) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2007, the $80,000 amount in clause (i) shall be increased by an amount equal to the product of—

(I) such dollar amount, and

(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "2006" for "1992" in subparagraph (B) thereof.

If any increase determined under the preceding sentence is not a multiple of $100, such increase shall be rounded to the next lowest multiple of $100.

* * *

[CCH Explanation at ¶ 133. Committee Reports at ¶ 11,870.]

Amendment Notes

Act Sec. 1172(a)(1)-(2) amended Code Sec. 911(b)(2) by striking "of $70,000" in subparagraph (A) and inserting "equal to the exclusion amount for the calendar year in which such taxable year begins", and by adding at the end a new subparagraph (D) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5293] CODE SEC. 927. OTHER DEFINITIONS AND SPECIAL RULES.

(a) EXPORT PROPERTY.—For purposes of this subpart—

* * *

(2) EXCLUDED PROPERTY.—The term "export property" shall not include—

(A) property leased or rented by a FSC for use by any member of a controlled group of corporations of which such FSC is a member,

(B) patents, inventions, models, designs, formulas, or processes whether or not patented, copyrights (other than films, tapes, records, or similar reproductions, *and other than computer software (whether or not patented)*, for commercial or home use), good will, trademarks, trade brands, franchises, or other like property,

(C) oil or gas (or any primary product thereof),

(D) products the export of which is prohibited or curtailed to effectuate the policy set forth in paragraph (2)(C) of section 3 of the Export Administration Act of 1979 (relating to the protection of the domestic economy), or

(E) any unprocessed timber which is a softwood.

For purposes of subparagraph (E), the term "unprocessed timber" means any log, cant, or similar form of timber.

* * *

[CCH Explanation at ¶ 950. Committee Reports at ¶ 11,865.]

Amendment Notes

Act Sec. 1171(a) amended Code Sec. 927(a)(2)(B) by inserting ", and other than computer software (whether or not patented)" before ", for commercial or home use".

The above amendment applies to gross receipts attributable to periods after December 31, 1997, in tax years ending after such date.

[¶ 5295] CODE SEC. 951. AMOUNTS INCLUDED IN GROSS INCOME OF UNITED STATES SHAREHOLDERS.

(a) AMOUNTS INCLUDED.—

* * *

(2) PRO RATA SHARE OF SUBPART F INCOME.—The pro rata share referred to in paragraph (1)(A)(i) in the case of any United States shareholder is the amount—

(A) which would have been distributed with respect to the stock which such shareholder owns (within the meaning of section 958(a)) in such corporation if on the last day, in its taxable year, on which the corporation is a controlled foreign corporation it had distributed pro rata to its shareholders an amount (i) which bears the same ratio to its subpart F income for the taxable year, as (ii) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year, reduced by

(B) the amount of distributions received by any other person during such year as a dividend with respect to such stock, but only to the extent of the dividend which would have been received if the distribution by the corporation had been the amount (i) which bears the same ratio to the subpart F income of such corporation for the taxable year, as (ii) the part of such year during which such shareholder did not own (within the meaning of section 958(a)) such stock bears to the entire year. *For purposes of subparagraph (B), any gain included in the gross income of any person as a dividend under section 1248 shall be treated as a distribution received by such person with respect to the stock involved.*

* * *

[CCH Explanation at ¶ 937. Committee Reports at ¶ 11,660.]

Amendment Notes

Act Sec. 1112(a)(1) amended Code Sec. 951(a)(2) by adding at the end thereof a new sentence to read as above.

The above amendment applies to dispositions after the date of the enactment of this Act.

[¶ 5297] CODE SEC. 952. SUBPART F INCOME DEFINED.

* * *

(b) EXCLUSION OF UNITED STATES INCOME.—In the case of a controlled foreign corporation, subpart F income does not include any item of income from sources within the United States which is effectively connected with the conduct by such corporation of a trade or business within the United States unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of

the United States. For purposes of the preceding sentence, income described in paragraph (2) or (3) of section 921(d) shall be treated as derived from sources within the United States. *For purposes of this subsection, any exemption (or reduction) with respect to the tax imposed by section 884 shall not be taken into account.*

* * *

[CCH Explanation at ¶ 937. Committee Reports at ¶ 11,660.]

Amendment Notes

Act Sec. 1112(c)(1) amended Code Sec. 952(b) by adding at the end thereof a new sentence to read as above.

The above amendment applies to tax years beginning after December 31, 1986.

[¶ 5299] CODE SEC. 954. FOREIGN BASE COMPANY INCOME.

* * *

(c) FOREIGN PERSONAL HOLDING COMPANY INCOME.—

(1) IN GENERAL.—For purposes of subsection (a)(1), the term "foreign personal holding company income" means the portion of the gross income which consists of:

(A) DIVIDENDS, ETC.—Dividends, interest, royalties, rents, and annuities.

(B) CERTAIN PROPERTY TRANSACTIONS.—The excess of gains over losses from the sale or exchange of property—

(i) which gives rise to income described in subparagraph (A) (after application of paragraph (2)(A)),

(ii) which is an interest in a trust, partnership, or REMIC, or

(iii) which does not give rise to any income.

Gains and losses from the sale or exchange of any property which, in the hands of the controlled foreign corporation, is properly described in section 1221(1) shall not be taken into account under this subparagraph.

* * *

(F) INCOME FROM NOTIONAL PRINCIPAL CONTRACTS.—Net income from notional principal contracts. Any item of income, gain, deduction, or loss from a notional principal contract entered into for purposes of hedging any item described in any preceding subparagraph shall not be taken into account for purposes of this subparagraph but shall be taken into account under such other subparagraph.

(G) PAYMENTS IN LIEU OF DIVIDENDS.—Payments in lieu of dividends which are made pursuant to an agreement to which section 1058 applies.

(2) EXCEPTION FOR CERTAIN AMOUNTS.—

* * *

(C) EXCEPTION FOR DEALERS.—Except as provided in subparagraph (A), (E), or (G) of paragraph (1) or by regulations, in the case of a regular dealer in property (within the meaning of paragraph (1)(B)), forward contracts, option contracts, or similar financial instruments (including notional principal contracts and all instruments referenced to commodities), there shall not be taken into account in computing foreign personal holding income any item of income, gain, deduction, or loss from any transaction (including hedging transactions) entered into in the ordinary course of such dealer's trade or business as such a dealer.

* * *

Amendment Notes

Act Sec. 1051(a)(1) amended Code Sec. 954(c)(1) by adding at the end new subparagraphs (F) and (G) to read as above.

Act Sec. 1051(a)(2)(A)-(B) amended Code Sec. 954(c)(1)(B) by striking the second sentence and by striking "also" after "1221(1)" in the last sentence. Prior to being stricken, the second sentence of Code Sec. 954(c)(1)(B) read as follows:

In the case of any regular dealer in property, gains and losses from the sale or exchange of any such property or arising out of bona fide hedging transactions reasonably necessary to the conduct of the business of being a dealer in such property shall not be taken into account under this subparagraph.

Act Sec. 1051(b) amended Code Sec. 954(c)(2) by adding at the end a new subparagraph (C) to read as above.

The above amendments apply to tax years beginning after the date of the enactment of this Act.

(e) FOREIGN BASE COMPANY SERVICES INCOME.—

* * *

[Caution: Act Sec. 1175 of the Taxpayer Relief Act of 1997 was canceled by President Clinton on August 11, 1997, pursuant to his authority under the Line Item Veto Act (P.L. 104-130). As we go to press, this provision is deemed to be stricken from the Act. However, under the procedures set out in P.L. 104-130 (or as the result of a successful challenge of its constitutionality), this provision may be reinstated at a later date.—CCH.]

(2) EXCEPTION.—Paragraph (1) shall not apply to income derived in connection with the performance of services which are directly related to—

(A) the sale or exchange by the controlled foreign corporation of property manufactured, produced, grown, or extracted by it and which are performed before the time of the sale or exchange,

(B) an offer or effort to sell or exchange such property*, or*

(C) in the case of taxable years described in subsection (h)(8), the active conduct by a controlled foreign corporation of a banking, financing, insurance, or similar business, but only if the corporation is predominantly engaged in the active conduct of such business (within the meaning of subsection (h)(3)) or is a qualifying insurance company.

* * *

Amendment Notes

Act Sec. 1175(b) amended Code Sec. 954(e)(2) by striking "or" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", or", and by adding at the end a new subparagraph (C) to read as above.

The above amendment applies to the first full tax year of a foreign corporation beginning after December 31, 1997, and before January 1, 1999, and to tax years of United States shareholders with or within which such tax year of foreign corporation end.

[Caution: Act Sec. 1175 of the Taxpayer Relief Act of 1997 was canceled by President Clinton on August 11, 1997, pursuant to his authority under the Line Item Veto Act (P.L. 104-130). As we go to press, this provision is deemed to be stricken from the Act. However, under the procedures set out in P.L. 104-130 (or as the result of a successful challenge of its constitutionality), this provision may be reinstated at a later date.—CCH.]

(h) SPECIAL RULE FOR INCOME DERIVED IN THE ACTIVE CONDUCT OF BANKING, FINANCING, OR SIMILAR BUSINESSES.—

(1) IN GENERAL.—For purposes of subsection (c)(1), foreign personal holding company income shall not include income which is—

(A) derived in the active conduct by a controlled foreign corporation of a banking, financing, or similar business, but only if the corporation is predominantly engaged in the active conduct of such business,

(B) received from a person other than a related person (within the meaning of subsection (d)(3)) and derived from the investments made by a qualifying insurance company of its reserves or of 80 percent of its unearned premiums (as both are determined in the manner prescribed under paragraph (4)), or

(C) received from a person other than a related person (within the meaning of subsection (d)(3)) and derived from investments made by a qualifying insurance company of an amount of its assets equal to—

(i) in the case of contracts regulated in the country in which sold as property, casualty, or health insurance contracts, one-third of its premiums earned on such insurance contracts during the taxable year (as defined in section 832(b)(4)), and

(ii) in the case of contracts regulated in the country in which sold as life insurance or annuity contracts, the greater of—

(I) 10 percent of the reserves described in subparagraph (B) for such contracts, or

(II) in the case of a qualifying insurance company which is a start-up company, $10,000,000.

(2) PRINCIPLES FOR DETERMINING APPLICABLE INCOME.—

(A) BANKING AND FINANCING INCOME.—The determination as to whether income is described in paragraph (1)(A) shall be made—

(i) except as provided in clause (ii), in accordance with the applicable principles of section 904(d)(2)(C)(ii), except that such income shall include income from all leases

entered into in the ordinary course of the active conduct of a banking, financing, or similar business, and

(ii) in the case of a corporation described in paragraph (3)(B), in accordance with the applicable principles of section 1296(b) (as in effect on the day before the enactment of the Taxpayer Relief Act of 1997) for determining what is not passive income.

(B) INSURANCE INCOME.—Under rules prescribed by the Secretary, for purposes of paragraphs (1) (B) and (C)—

(i) in the case of contracts which are separate account-type contracts (including variable contracts not meeting the requirements of section 817), only income specifically allocable to such contracts shall be taken into account, and

(ii) in the case of other contracts, income not allocable under clause (i) shall be allocated ratably among such contracts.

(C) LOOK-THRU RULES.—The Secretary shall prescribe regulations consistent with the principles of section 904(d)(3) which provide that dividends, interest, income equivalent to interest, rents, or royalties received or accrued from a related person (within the meaning of subsection (d)(3)) shall be subject to look-thru treatment for purposes of this subsection.

(3) PREDOMINANTLY ENGAGED.—For purposes of paragraph (1)(A), a corporation shall be deemed predominantly engaged in the active conduct of a banking, financing, or similar business only if—

(A) more than 70 percent of its gross income is derived from such business from transactions with persons which are not related persons (as defined in subsection (d)(3)) and which are located within the country under the laws of which the controlled foreign corporation is created or organized, or

(B) the corporation is—

(i) engaged in the active conduct of a banking or securities business (within the meaning of section 1296(b), as in effect before the enactment of the Taxpayer Relief Act of 1997), or

(ii) a qualified bank affiliate or a qualified securities affiliate (within the meaning of the proposed regulations under such section 1296(b)).

(4) METHODS FOR DETERMINING UNEARNED PREMIUMS AND RESERVES.—For purposes of paragraph (1)(B)—

(A) PROPERTY AND CASUALTY CONTRACTS.—The unearned premiums and reserves of a qualifying insurance company with respect to property, casualty, or health insurance contracts shall be determined using the same methods and interest rates which would be used if such company were subject to tax under subchapter L.

(B) LIFE INSURANCE AND ANNUITY CONTRACTS.—The reserves of a qualifying insurance company with respect to life insurance or annuity contracts shall be determined under the method described in paragraph (5) which such company elects to apply for purposes of this paragraph. Such election shall be made at such time and in such manner as the Secretary may prescribe and, once made, shall be irrevocable without the consent of the Secretary.

(C) LIMITATION ON RESERVES.—In no event shall the reserve determined under this paragraph for any contract as of any time exceed the amount which would be taken into account with respect to such contract as of such time in determining foreign annual statement reserves (less any catastrophe or deficiency reserves).

(5) METHODS.—The methods described in this paragraph are as follows:

(A) U.S. METHOD.—The method which would apply if the qualifying insurance company were subject to tax under subchapter L, except that the interest rate used shall be an interest rate determined for the foreign country in which such company is created or organized and which is calculated in the same manner as the Federal mid-term rate under section 1274(d).

(B) FOREIGN METHOD.—A preliminary term method, except that the interest rate used shall be the interest rate determined for the foreign country in which such company is created or organized and which is calculated in the same manner as the Federal mid-term rate under section 1274(d). If a qualifying insurance company uses such a preliminary term method with respect to contracts insuring risks located in such foreign country, such method shall apply if such company elects the method under this clause.

(C) CASH SURRENDER VALUE.—A method under which reserves are equal to the net surrender value (as defined in section 807(e)(1)(A)) of the contract.

(6) DEFINITIONS.—For purposes of this subsection—

(A) TERMS RELATING TO INSURANCE COMPANIES.—

(i) QUALIFYING INSURANCE COMPANY.—The term "qualifying insurance company" means any entity which—

(I) is subject to regulation as an insurance company under the laws of its country of incorporation,

(II) realizes at least 50 percent of its net written premiums from the insurance or reinsurance of risks located within the country in which such entity is created or organized, and

(III) is engaged in the active conduct of an insurance business and would be subject to tax under subchapter L if it were a domestic corporation.

(ii) START-UP COMPANY.—A qualifying insurance company shall be treated as a start-up company if such company (and any predecessor) has not been engaged in the active conduct of an insurance business for more than 5 years as of the beginning of the taxable year of such company.

(B) LOCATED.—For purposes of paragraph (3)(A)—

(i) IN GENERAL.—A person shall be treated as located—

(I) except as provided in subclause (II), within the country in which it maintains an office or other fixed place of business through which it engages in a trade or business and by which the transaction is effected, or

(II) in the case of a natural person, within the country in which such person is physically located when such person enters into a transaction.

(ii) SPECIAL RULE FOR QUALIFIED BUSINESS UNITS.—Gross income derived by a corporation's qualified business unit (within the meaning of section 989(a)) from transactions with persons which are not related persons (as defined in subsection (d)(3)) and which are located in the country in which the qualified business unit both maintains its principal office and conducts substantial business activity shall be treated as derived from transactions with persons which are not related persons (as defined in subsection (d)(3)) and which are located within the country under the laws of which the controlled foreign corporation is created or organized.

(7) ANTI-ABUSE RULES.—For purposes of applying this subsection, there shall be disregarded any item of income, gain, loss, or deduction with respect to any transaction or series of transactions one of the principal purposes of which is qualifying income or gain for the exclusion under this section, including any change in the method of computing reserves or any other transaction or series of transactions a principal purpose of which is the acceleration or deferral of any item in order to claim the benefits of such exclusion through the application of this subsection.

(8) COORDINATION WITH SECTION 953.—This subsection shall not apply to investment income allocable to contracts that insure related party risks or risks located in a foreign country other than the country in which the qualifying insurance comapny is created or organized.

(9) APPLICATION.—This subsection shall apply to the first full taxable year of a foreign corporation beginning after December 31, 1997, and before January 1, 1999, and to taxable years of United States shareholders with or within which such taxable year of such foreign corporation ends.

* * *

[CCH Explanation at ¶ 936 and 942. Committee Reports at ¶ 11,365 and 11,885.]

Amendment Notes

Act Sec. 1175(a) amended Code Sec. 954 by adding at the end a new subsection (h) to read as above.

The above amendment applies to the first full tax year of a foreign corporation beginning after December 31, 1997, and before January 1, 1999, and to tax years of United States shareholders with or within which such tax year of such foreign corporation ends.

[¶ 5301] CODE SEC. 956. INVESTMENT OF EARNINGS IN UNITED STATES PROPERTY.

* * *

(b) SPECIAL RULES.—

(1) APPLICABLE EARNINGS.—For purposes of this section, the term "applicable earnings" means, with respect to any controlled foreign corporation, the sum of—

(A) the amount (not including a deficit) referred to in section 316(a)(1) *to the extent such amount was accumulated in prior taxable years,* and

(B) the amount referred to in section 316(a)(2),

but reduced by distributions made during the taxable year and by earnings and profits described in section 959(c)(1).

* * *

Amendment Notes

Act Sec. 1601(e) amended Code Sec. 956(b)(1)(A) by inserting "to the extent such amount was accumulated in prior taxable years" after "section 316(a)(1)".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years of foreign corporations beginning after December 31, 1996, and tax years of U.S. shareholders within which or with which such tax years of foreign corporations end.—CCH.].

(c) UNITED STATES PROPERTY DEFINED.—

* * *

(2) EXCEPTIONS.—For purposes of subsection (a), the term "United States property" does not include—

(A) obligations of the United States, money, or deposits with persons carrying on the banking business;

(B) property located in the United States which is purchased in the United States for export to, or use in, foreign countries;

(C) any obligation of a United States person arising in connection with the sale or processing of property if the amount of such obligation outstanding at no time during the taxable year exceeds the amount which would be ordinary and necessary to carry on the trade or business of both the other party to the sale or processing transaction and the United States person had the sale or processing transaction been made between unrelated persons;

(D) any aircraft, railroad rolling stock, vessel, motor vehicle, or container used in the transportation of persons or property in foreign commerce and used predominantly outside the United States;

(E) an amount of assets of an insurance company equivalent to the unearned premiums or reserves ordinary and necessary for the proper conduct of its insurance business attributable to contracts which are not contracts described in section 953(a)(1);

(F) the stock or obligations of a domestic corporation which is neither a United States shareholder (as defined in section 951(b)) of the controlled foreign corporation, nor a domestic corporation, 25 percent or more of the total combined voting power of which, immediately after the acquisition of any stock in such domestic corporation by the controlled foreign corporation, is owned, or is considered as being owned, by such United States shareholders in the aggregate;

(G) any movable property (other than a vessel or aircraft) which is used for the purpose of exploring for, developing, removing, or transporting resources from ocean waters or under such waters when used on the Continental Shelf of the United States;

(H) an amount of assets of the controlled foreign corporation equal to the earnings and profits accumulated after December 31, 1962, and excluded from subpart F income under section 952(b);

(I) to the extent provided in regulations prescribed by the Secretary, property which is otherwise United States property which is held by a FSC and which is related to the export activities of such FSC*;*

(J) deposits of cash or securities made or received on commercial terms in the ordinary course of a United States or foreign person's business as a dealer in securities or in commodities, but only to the extent such deposits are made or received as collateral or margin for (i) a securities loan, notional principal contract, options contract, forward contract, or futures contract, or (ii) any other financial transaction in which the Secretary determines that it is customary to post collateral or margin; and

(K) an obligation of a United States person to the extent the principal amount of the obligation does not exceed the fair market value of readily marketable securities sold or purchased pursuant to a sale and repurchase agreement or otherwise posted or received as

collateral for the obligation in the ordinary course of its business by a United States or foreign person which is a dealer in securities or commodities.

For purposes of subparagraphs (J) and (K), the term "dealer in securities" has the meaning given such term by section 475(c)(1), and the term "dealer in commodities" has the meaning given such term by section 475(e), except that such term shall include a futures commission merchant.

* * *

[CCH Explanation at ¶ 938 and 940. Committee Reports at ¶ 11,875 and 13,645.]

Amendment Notes

Act Sec. 1173(a) amended Code Sec. 956(c)(2) by striking "and" at the end of subparagraph (H), by striking the period at the end of subparagraph (I) and inserting a semicolon, and by adding at the end new subparagraphs (J) and (K) and a new flush sentence to read as above.

The above amendment applies to tax years of foreign corporations beginning after December 31, 1997, and to tax years of United States shareholders with or within which such tax years of foreign corporations end.

[¶ 5303] CODE SEC. 960. SPECIAL RULES FOR FOREIGN TAX CREDITS.

(a) TAXES PAID BY A FOREIGN CORPORATION.—

(1) DEEMED PAID CREDIT.—For purposes of subpart A of this part, if there is included under section 951(a) in the gross income of a domestic corporation any amount attributable to earnings and profits of a foreign corporation which is a member of a qualified group (as defined in section 902(b)) with respect to the domestic corporation, then, except to the extent provided in regulations, section 902 shall be applied as if the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B)).

* * *

[CCH Explanation at ¶ 934. Committee Reports at ¶ 11,665.]

Amendment Notes

Act Sec. 1113(b) amended Code Sec. 960(a)(1) to read as above. Prior to amendment, Code Sec. 960(a)(1) read as follows:

(1) GENERAL RULE.—For purposes of subpart A of this part, if there is included, under section 951(a), in the gross income of a domestic corporation any amount attributable to earnings and profits—

(A) of a foreign corporation (hereafter in this subsection referred to as the "first foreign corporation") at least 10 percent of the voting stock of which is owned by such domestic corporation, or

(B) of a second foreign corporation (hereinafter in this subsection referred to as the "second foreign corporation") at least 10 percent of the voting stock of which is owned by the first foreign corporation, or

(C) of a third foreign corporation (hereinafter in this subsection referred to as the "third foreign corporation") at least 10 percent of the voting stock of which is owned by the second foreign corporation,

then, except to the extent provided in regulations, such domestic corporation shall be deemed to have paid a portion of such foreign corporation's post-1986 foreign income taxes determined under section 902 in the same manner as if the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B)). This paragraph shall not apply with respect to any amount included in the gross income of such domestic corporation attributable to earnings and profits of the second foreign corporation or of the third foreign corporation unless, in the case of the second foreign corporation, the percentage-of-voting-stock requirement of section 902(b)(3)(A) is satisfied, and in the case of the third foreign corporation, the percentage-of-voting-stock requirement of section 902(b)(3)(B) is satisfied.

The above amendment generally applies to taxes of foreign corporations for tax years of such corporations beginning after the date of enactment of this Act. For a special rule, see Act Sec. 1113(c)(2), below.

Act Sec. 1113(c)(2) provides:

(2) SPECIAL RULE.—In the case of any chain of foreign corporations described in clauses (i) and (ii) of section 902(b)(2)(B) of the Internal Revenue Code of 1986 (as amended by this section), no liquidation, reorganization, or similar transaction in a taxable year beginning after the date of the enactment of this Act shall have the effect of permitting taxes to be taken into account under section 902 of the Internal Revenue Code of 1986 which could not have been taken into account under such section but for such transaction.

[¶ 5305] CODE SEC. 961. ADJUSTMENTS TO BASIS OF STOCK IN CONTROLLED FOREIGN CORPORATIONS AND OF OTHER PROPERTY.

* * *

(c) BASIS ADJUSTMENTS IN STOCK HELD BY FOREIGN CORPORATION.—Under regulations prescribed by the Secretary, if a United States shareholder is treated under section 958(a)(2) as owning any stock in a controlled foreign corporation which is actually owned by another controlled foreign corporation, adjustments similar to the adjustments provided by subsections (a) and (b) shall be made to the basis of such stock in the hands of such other controlled foreign corporation, but only for the purposes of determining the amount included under section 951 in the gross income of such United States shareholder (or any other United States shareholder who acquires from any person any portion of the interest of such United States shareholder by reason of which such shareholder was treated as owning such stock, but only

to the extent of such portion, and subject to such proof of identity of such interest as the Secretary may prescribe by regulations).

* * *

[CCH Explanation at ¶ 937. Committee Reports at ¶ 11,660.]

Amendment Notes

Act Sec. 1112(b)(1) amended Code Sec. 961 by adding at the end a new subsection (c) to read as above.

The above amendment applies for purposes of determining inclusions for tax years of United States shareholders beginning after December 31, 1997.

[¶ 5307] CODE SEC. 964. MISCELLANEOUS PROVISIONS.

* * *

(e) GAIN ON CERTAIN STOCK SALES BY CONTROLLED FOREIGN CORPORATIONS TREATED AS DIVIDENDS.—

(1) IN GENERAL.—If a controlled foreign corporation sells or exchanges stock in any other foreign corporation, gain recognized on such sale or exchange shall be included in the gross income of such controlled foreign corporation as a dividend to the same extent that it would have been so included under section 1248(a) if such controlled foreign corporation were a United States person. For purposes of determining the amount which would have been so includible, the determination of whether such other foreign corporation was a controlled foreign corporation shall be made without regard to the preceding sentence.

(2) SAME COUNTRY EXCEPTION NOT APPLICABLE.—Clause (i) of section 954(c)(3)(A) shall not apply to any amount treated as a dividend by reason of paragraph (1).

(3) CLARIFICATION OF DEEMED SALES.—For purposes of this subsection, a controlled foreign corporation shall be treated as having sold or exchanged any stock if, under any provision of this subtitle, such controlled foreign corporation is treated as having gain from the sale or exchange of such stock.

* * *

[CCH Explanation at ¶ 932. Committee Reports at ¶ 11,655.]

Amendment Notes

Act Sec. 1111(a) amended Code Sec. 964 by adding at the end a new subsection (e) to read as above.

The above amendment applies to gain recognized on transactions occurring after the date of the enactment of this Act.

[¶ 5309] CODE SEC. 986. DETERMINATION OF FOREIGN TAXES AND FOREIGN CORPORATION'S EARNINGS AND PROFITS.

(a) FOREIGN INCOME TAXES.—

(1) TRANSLATION OF ACCRUED TAXES.—

(A) IN GENERAL.—For purposes of determining the amount of the foreign tax credit, in the case of a taxpayer who takes foreign income taxes into account when accrued, the amount of any foreign income taxes (and any adjustment thereto) shall be translated into dollars by using the average exchange rate for the taxable year to which such taxes relate.

(B) EXCEPTION FOR CERTAIN TAXES.—Subparagraph (A) shall not apply to any foreign income taxes—

(i) paid after the date 2 years after the close of the taxable year to which such taxes relate, or

(ii) paid before the beginning of the taxable year to which such taxes relate.

(C) EXCEPTION FOR INFLATIONARY CURRENCIES.—Subparagraph (A) shall not apply to any foreign income taxes the liability for which is denominated in any inflationary currency (as determined under regulations).

(D) CROSS REFERENCE.—

For adjustments where tax is not paid within 2 years, see section 905(c).

(2) TRANSLATION OF TAXES TO WHICH PARAGRAPH (1) DOES NOT APPLY.—For purposes of determining the amount of the foreign tax credit, in the case of any foreign income taxes to which subparagraph (A) of paragraph (1) does not apply—

(A) such taxes shall be translated into dollars using the exchange rates as of the time such taxes were paid to the foreign country or possession of the United States, and

(B) any adjustment to the amount of such taxes shall be translated into dollars using—

(i) except as provided in clause (ii), the exchange rate as of the time when such adjustment is paid to the foreign country or possession, or

(ii) in the case of any refund or credit of foreign income taxes, using the exchange rate as of the time of the original payment of such foreign income taxes.

(3) AUTHORITY TO PERMIT USE OF AVERAGE RATES.—To the extent prescribed in regulations, the average exchange rate for the period (specified in such regulations) during which the taxes or adjustment is paid may be used instead of the exchange rate as of the time of such payment.

(4) FOREIGN INCOME TAXES.—For purposes of this subsection, the term "foreign income taxes" means any income, war profits, or excess profits taxes paid or accrued to any foreign country or to any possession of the United States.

* * *

[CCH Explanation at ¶ 901. Committee Reports at ¶ 11,620.]

Amendment Notes

Act Sec. 1102(a)(1) amended Code Sec. 986(a) to read as above. Prior to amendment, Code Sec. 986(a) read as follows:

(a) FOREIGN TAXES.—

(1) IN GENERAL.—For purposes of determining the amount of the foreign tax credit—

(A) any foreign income taxes shall be translated into dollars using the exchange rates as of the time such taxes were paid to the foreign country or possession of the United States, and

(B) any adjustment to the amount of foreign income taxes shall be translated into dollars using—

(i) except as provided in clause (ii), the exchange rate as of the time when such adjustment is paid to the foreign country or possession, or

(ii) in the case of any refund or credit of foreign income taxes, using the exchange rate as of the time of original payment of such foreign income taxes.

(2) FOREIGN INCOME TAXES.—For purposes of paragraph (1), "foreign income taxes" means any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States.

Act Sec. 1102(b)(1) amended Code Sec. 986(a) (as amended by Act Sec. 1102(a)) by redesignating paragraph (3) as paragraph (4) and inserting after paragraph (2) a new paragraph (3) to read as above.

The above amendments apply to taxes paid or accrued in tax years beginning after December 31, 1997.

[¶ 5311] CODE SEC. 988. TREATMENT OF CERTAIN FOREIGN CURRENCY TRANSACTIONS.

* * *

(e) APPLICATION TO INDIVIDUALS.—

(1) IN GENERAL.—The preceding provisions of this section shall not apply to any section 988 transaction entered into by an individual which is a personal transaction.

(2) EXCLUSION FOR CERTAIN PERSONAL TRANSACTIONS.—If—

(A) nonfunctional currency is disposed of by an individual in any transaction, and

(B) such transaction is a personal transaction,

no gain shall be recognized for purposes of this subtitle by reason of changes in exchange rates after such currency was acquired by such individual and before such disposition. The preceding sentence shall not apply if the gain which would otherwise be recognized on the transaction exceeds $200.

(3) PERSONAL TRANSACTIONS.—For purposes of this subsection, the term "personal transaction" means any transaction entered into by an individual, except that such term shall not include any transaction to the extent that expenses properly allocable to such transaction meet the requirements of—

(A) section 162 (other than traveling expenses described in subsection (a)(2) thereof), or

(B) section 212 (other than that part of section 212 dealing with expenses incurred in connection with taxes).

[CCH Explanation at ¶ 953. Committee Reports at ¶ 11,630.]

Amendment Notes

Act Sec. 1104(a) amended Code Sec. 988(e) to read as above. Prior to amendment, Code Sec. 988(e) read as follows:

(e) APPLICATION TO INDIVIDUALS.—This section shall apply to section 988 transactions entered into by an individual only to the extent expenses properly allocable to such transactions meet the requirements of section 162 or 212 (other than that part of section 212 dealing with expenses incurred in connection with taxes).

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5313] CODE SEC. 989. OTHER DEFINITIONS AND SPECIAL RULES.

* * *

(b) APPROPRIATE EXCHANGE RATE.—Except as provided in regulations, for purposes of this subpart, the term "appropriate exchange rate" means—

(1) in the case of an actual distribution of earnings and profits, the spot rate on the date such distribution is included in income,

(2) in the case of an actual or deemed sale or exchange of stock in a foreign corporation treated as a dividend under section 1248, the spot rate on the date the deemed dividend is included in income,

(3) in the case of any amounts included in income under section 951(a)(1)(A), 551(a), or 1293(a), the averaged exchange rate for the taxable year of the foreign corporation, or

(4) in the case of any other qualified business unit of a taxpayer, the average exchange rate for the taxable year of such qualified business unit.

For purposes of the preceding sentence, any amount included in income under section 951(a)(1)(B) shall be treated as an actual distribution made on the last day of the taxable year for which such amount was so included.

Amendment Notes

Act Sec. 1102(b)(3) amended Code Sec. 989(b) by striking "weighted" each place it appears. Prior to amendment, Code Sec. 989(b) read as follows:

(b) APPROPRIATE EXCHANGE RATE.—Except as provided in regulations, for purposes of this subpart, the term "appropriate exchange rate" means—

(1) in the case of an actual distribution of earnings and profits, the spot rate on the date such distribution is included in income,

(2) in the case of an actual or deemed sale or exchange of stock in a foreign corporation treated as a dividend under section 1248, the spot rate on the date the deemed dividend is included in income,

(3) in the case of any amounts included in income under section 951(a)(1)(A), 551(a), or 1293(a), the weighted averaged exchange rate for the taxable year of the foreign corporation, or

(4) in the case of any other qualified business unit of a taxpayer, the weighted average exchange rate for the taxable year of such qualified business unit.

For purposes of the preceding sentence, any amount included in income under section 951(a)(1)(B) shall be treated as an actual distribution made on the last day of the taxable year for which such amount was so included.

The above amendment applies to taxes paid or accrued in tax years beginning after December 31, 1997.

(c) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subpart, including regulations—

(1) setting forth procedures to be followed by taxpayers with qualified business units using a net worth method of accounting before the enactment of this subpart,

(2) limiting the recognition of foreign currency loss on certain remittances from qualified business units,

(3) providing for the recharacterization of interest and principal payments with respect to obligations denominated in certain hyperinflationary currencies,

(4) providing for alternative adjustments to the application of section 905(c),

(5) providing for the appropriate treatment of related party transactions (including transactions between qualified business units of the same taxpayer)*, and*

(6) setting forth procedures for determining the average exchange rate for any period.

* * *

[CCH Explanation at ¶ 901. Committee Reports at ¶ 11,620.]

Amendment Notes

Act Sec. 1102(b)(2) amended Code Sec. 989(c) by striking "and" at the end of paragraph (4), by striking the period at the end of paragraph (5) and inserting ", and", and by adding at the end thereof a new paragraph (6) to read as above.

The above amendment applies to taxes paid or accrued in tax years beginning after December 31, 1997.

[¶ 5315] CODE SEC. 1014. BASIS OF PROPERTY ACQUIRED FROM A DECEDENT.

(a) IN GENERAL.—Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be—

(1) the fair market value of the property at the date of the decedent's death,

(2) in the case of an election under either section 2032 or section 811(j) of the Internal Revenue Code of 1939 where the decedent died after October 21, 1942, its value at the applicable valuation date prescribed by those sections,

(3) in the case of an election under section 2032A, its value determined under such section*, or*

(4) to the extent of the applicability of the exclusion described in section 2031(c), the basis in the hands of the decedent.

* * *

[CCH Explanation at ¶ 214. Committee Reports at ¶ 10,420.]

Amendment Notes

Act Sec. 508(b) amended Code Sec. 1014(a) by striking "or" at the end of paragraphs (1) and (2), by striking the

period at the end of paragraph (3) and inserting ", or" and by adding at the end a new paragraph (4) to read as above.

The above amendment applies to estates of decedents dying after December 31, 1997.

[¶ 5317] CODE SEC. 1016. ADJUSTMENTS TO BASIS.

(a) GENERAL RULE.—Proper adjustment in respect of the property shall in all cases be made—

* * *

(7) in the case of a residence the acquisition of which resulted, under section 1034 *(as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997)*, in the nonrecognition of any part of the gain realized on the sale, exchange, or involuntary conversion of another residence, to the extent provided in section 1034(e) *(as so in effect)*;

* * *

(23) in the case of property the acquisition of which resulted under section 1043*, 1044, or 1045* in the nonrecognition of any part of the gain realized on the sale of other property, to the extent provided in section 1043(c)*, 1044(d), or 1045(b)(4)* , as the case may be,

* * *

(25) to the extent provided in section 30(d)(1),

(26) to the extent provided in sections 23(g) and 137(e)*, and*

(27) in the case of a residence with respect to which a credit was allowed under section 1400C, to the extent provided in section 1400C(h).

* * *

[CCH Explanation at ¶ 129, 306 and 387. Committee Reports at ¶ 10,315, 10,320 and 10,465.]

Amendment Notes

Act Sec. 312(d)(6) amended Code Sec. 1016(a)(7) by inserting "(as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997)" after "1034" and by inserting "(as so in effect)" after "1034(e)".

The above amendment generally applies to sales and exchanges after May 6, 1997.

Act Sec. 313(b)(1)(A)-(B) amended Code Sec. 1016(a)(23) by striking "or 1044" and inserting ", 1044, or 1045", and by striking "or 1044(d)" and inserting ", 1044(d), or 1045(b)(4)".

The above amendment applies to sales after the date of enactment of this Act.

Act Sec. 701(b)(2) amended Code Sec. 1016(a) by striking "and" at the end of paragraph (25), by striking the period at the end of paragraph (26) and inserting ", and", and by adding at the end a new paragraph (27) to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5319] CODE SEC. 1031. EXCHANGE OF PROPERTY HELD FOR PRODUCTIVE USE OR INVESTMENT.

* * *

(h) SPECIAL RULES FOR FOREIGN REAL AND PERSONAL PROPERTY.—For purposes of this section—

(1) REAL PROPERTY.—Real property located in the United States and real property located outside the United States are not property of a like kind.

(2) PERSONAL PROPERTY.—

(A) IN GENERAL.—Personal property used predominantly within the United States and personal property used predominantly outside the United States are not property of a like kind.

(B) PREDOMINANT USE.—Except as provided in subparagraph (C) and (D), the predominant use of any property shall be determined based on—

(i) in the case of the property relinquished in the exchange, the 2-year period ending on the date of such relinquishment, and

(ii) in the case of the property acquired in the exchange, the 2-year period beginning on the date of such acquisition.

(C) PROPERTY HELD FOR LESS THAN 2 YEARS.—Except in the case of an exchange which is part of a transaction (or series of transactions) structured to avoid the purposes of this subsection—

(i) only the periods the property was held by the person relinquishing the property (or any related person) shall be taken into account under subparagraph (B)(i), and

(ii) only the periods the property was held by the person acquiring the property (or any related person) shall be taken into account under subparagraph (B)(ii).

(D) Special rule for certain property.—Property described in any subparagraph of section 168(g)(4) shall be treated as used predominantly in the United States.

* * *

[CCH Explanation at ¶ 336. Committee Reports at ¶ 11,370.]

Amendment Notes

Act Sec. 1052(a) amended Code Sec. 1031(h) to read as above. Prior to amendment, Code Sec. 1031(h) read as follows:

(h) Special Rule for Foreign Real Property.—For purposes of this section, real property located in the United States and real property located outside the United States are not property of a like kind.

The above amendment generally applies to transfers after June 8, 1997, in tax years ending after such date. For a special rule, see Act Sec. 1052(b)(2), below.

Act Sec. 1052(b)(2) provides:

(2) Binding contracts.—The amendment made by this section shall not apply to any transfer pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before the disposition of property. A contract shall not fail to meet the requirements of the preceding sentence solely because—

(A) it provides for a sale in lieu of an exchange, or

(B) the property to be acquired as replacement property was not identified under such contract before June 9, 1997.

[¶ 5321] CODE SEC. 1033. INVOLUNTARY CONVERSIONS.

* * *

(e) Livestock Sold on Account of Drought, *Flood, or Other Weather-Related Conditions.*—For purposes of this subtitle, the sale or exchange of livestock (other than poultry) held by a taxpayer for draft, breeding, or dairy purposes in excess of the number the taxpayer would sell if he followed his usual business practices shall be treated as an involuntary conversion to which this section applies if such livestock are sold or exchanged by the taxpayer solely on account of drought, *flood, or other weather-related conditions.*

* * *

Amendment Notes

Act Sec. 913(b)(1)-(2) amended Code Sec. 1033(e) by inserting ", flood, or other weather-related conditions" before the period at the end thereof and by inserting ", Flood, or Other Weather-Related Conditions" after "Drought" in the heading.

The above amendment applies to sales and exchanges after December 31, 1996.

* * *

(h) Special Rules for Property Damaged by Presidentially Declared Disasters.—

* * *

(4) Principal residence.—For purposes of this subsection, the term "principal residence" has the same meaning as when used in *section 121*, except that such term shall include a residence not treated as a principal residence solely because the taxpayer does not own the residence.

Amendment Notes

Act Sec. 312(d)(1) amended Code Sec. 1033(h)(4) by striking "section 1034" and inserting "section 121".

The above amendment applies to sales and exchanges after May 6, 1997.

(i) Replacement Property Must Be Acquired From Unrelated Person in Certain Cases.—

(1) In general.—If the property which is involuntarily converted is held by a taxpayer to which this subsection applies, subsection (a) shall not apply if the replacement property or stock is acquired from a related person. The preceding sentence shall not apply to the extent that the related person acquired the replacement property or stock from an unrelated person during the period applicable under subsection (a)(2)(B).

(2) Taxpayers to which subsection applies.—This subsection shall apply to—

(A) a C corporation,

(B) a partnership in which 1 or more C corporations own, directly or indirectly (determined in accordance with section 707(b)(3)), more than 50 percent of the capital interest, or profits interest, in such partnership at the time of the involuntary conversion, and

(C) any other taxpayer if, with respect to property which is involuntarily converted during the taxable year, the aggregate of the amount of realized gain on such property on which there is realized gain exceeds $100,000.

In the case of a partnership, subparagraph (C) shall apply with respect to the partnership and with respect to each partner. A similar rule shall apply in the case of an S corporation and its shareholders.

(3) Related person.—For purposes of this subsection, a person is related to another person if the person bears a relationship to the other person described in section 267(b) or 707(b)(1).

* * *

Amendment Notes

Act Sec. 1087(a) amended Code Sec. 1033(i) to read as above. Prior to amendment, Code Sec. 1033(i) read as follows:

(i) NONRECOGNITION NOT TO APPLY IF CORPORATION ACQUIRES REPLACEMENT PROPERTY FROM RELATED PERSON.—

(1) IN GENERAL.—In the case of—

(A) a C corporation, or

(B) a partnership in which 1 or more C corporations own, directly or indirectly (determined in accordance with section 707(b)(3)), more than 50 percent of the capital interest, or profits interest, in such partnership at the time of the involuntary conversion,

subsection (a) shall not apply if the replacement property or stock is acquired from a related person. The preceding sentence shall not apply to the extent that the related person acquired the replacement property or stock from an unrelated person during the period described in subsection (a)(2)(B).

(2) RELATED PERSON.—For purposes of this subsection, a person is related to another person if the person bears a relationship to the other person described in section 267(b) or 707(b)(1).

The above amendment applies to involuntary conversions occurring after June 8, 1997.

(k) CROSS REFERENCES.—

* * *

(3) For exclusion from gross income of gain from involuntary conversion of principal residence, see section 121.

* * *

[CCH Explanation at ¶ 129, 334 and 367. Committee Reports at ¶ 10,315, 10,595 and 11,545.]

Amendment Notes

Act Sec. 312(d)(7) amended Code Sec. 1033(k)(3) to read as above. Prior to amendment, Code Sec. 1033(k)(3) read as follows:

(3) For one-time exclusion from gross income of gain from involuntary conversion of principal residence by individual who has attained age 55, see section 121.

The above amendment applies to sales and exchanges after May 6, 1997.

[¶ 5323] CODE SEC. 1034. ROLLOVER OF GAIN ON SALE OF PRINCIPAL RESIDENCE. *[REPEALED.]*

[CCH Explanation at ¶ 129. Committee Reports at ¶ 10,315.]

Amendment Notes

Act Sec. 312(b) repealed Code Sec. 1034. Prior to repeal, Code Sec. 1034 read as follows:

SEC. 1034. ROLLOVER OF GAIN ON SALE OF PRINCIPAL RESIDENCE.

(a) NONRECOGNITION OF GAIN.—If property (in this section called "old residence") used by the taxpayer as his principal residence is sold by him and, within a period beginning 2 years before the date of such sale and ending 2 years after such date, property (in this section called "new residence") is purchased and used by the taxpayer as his principal residence, gain (if any) from such sale shall be recognized only to the extent that the taxpayer's adjusted sales price (as defined in subsection (b)) of the old residence exceeds the taxpayer's cost of purchasing the new residence.

(b) ADJUSTED SALES PRICE DEFINED.—

(1) IN GENERAL.—For purposes of this section, the term "adjusted sales price" means the amount realized, reduced by the aggregate of the expenses for work performed on the old residence in order to assist in its sale.

(2) LIMITATIONS.—The reduction provided in paragraph (1) applies only to expenses—

(A) for work performed during the 90-day period ending on the day on which the contract to sell the old residence is entered into;

(B) which are paid on or before the 30th day after the date of the sale of the old residence; and

(C) which are—

(i) not allowable as deductions in computing taxable income under section 63 (defining taxable income), and

(ii) not taken into account in computing the amount realized from the sale of the old residence.

(c) RULES FOR APPLICATION OF SECTION.—For purposes of this section:

(1) An exchange by the taxpayer of his residence for other property shall be treated as a sale of such residence, and the acquisition of a residence on the exchange of property shall be treated as a purchase of such residence.

(2) A residence any part of which was constructed or reconstructed by the taxpayer shall be treated as purchased by the taxpayer. In determining the taxpayer's cost of purchasing a residence, there shall be included only so much of his cost as is attributable to the acquisition, construction, reconstruction, and improvements made which are properly chargeable to capital account, during the period specified in subsection (a).

(3) If a residence is purchased by the taxpayer before the date of his sale of the old residence, the purchased residence shall not be treated as his new residence if sold or otherwise disposed of by him before the date of the sale of the old residence.

(4) If the taxpayer, during the period described in subsection (a), purchases more than one residence which is used by him as his principal residence at some time within 2 years after the date of the sale of the old residence, only the last of such residences so used by him after the date of such sale shall constitute the new residence. If a principal residence is sold in a sale to which subsection (d)(2) applies within 2 years after the sale of the old residence, for purposes of applying the preceding sentence with respect to the old residence, the principal residence so sold shall be treated as the last residence used during such 2-year period.

(d) LIMITATION.—

(1) IN GENERAL.—Subsection (a) shall not apply with respect to the sale of the taxpayer's residence if within 2 years before the date of such sale the taxpayer sold at a gain other property used by him as his principal residence, and any part of such gain was not recognized by reason of subsection (a).

(2) SUBSEQUENT SALE CONNECTED WITH COMMENCING WORK AT NEW PLACE.—Paragraph (1) shall not apply with respect to the sale of the taxpayer's residence if—

(A) such sale was in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work, and

(B) if the residence so sold is treated as the former residence for purposes of section 217 (relating to moving expenses), the taxpayer would satisfy the conditions of sub-

section (c) of section 217 (as modified by the other subsections of such section).

(e) BASIS OF NEW RESIDENCE.—Where the purchase of a new residence results, under subsection (a) or under section 112(n)) of the Internal Revenue Code of 1939, in the nonrecognition of gain on the sale of an old residence, in determining the adjusted basis of the new residence as of any time following the sale of the old residence, the adjustments to basis shall include a reduction by an amount equal to the amount of the gain not so recognized on the sale of the old residence. For this purpose, the amount of the gain not so recognized on the sale of the old residence includes only so much of such gain as is not recognized by reason of the cost, up to such time, of purchasing the new residence.

(f) TENANT-STOCKHOLDER IN A COOPERATIVE HOUSING CORPORATION.—For purposes of this section, section 1016 (relating to adjustments to basis), and section 1223 (relating to holding period), references to property used by the taxpayer as his principal residence, and references to the residence of a taxpayer, shall include stock held by a tenant-stockholder (as defined in section 216, relating to deduction for amounts representing taxes and interest paid to a cooperative housing corporation) in a cooperative housing corporation (as defined in such section) if—

(1) in the case of stock sold, the house or apartment which the taxpayer was entitled to occupy as such stockholder was used by him as his principal residence, and

(2) in the case of stock purchased, the taxpayer used as his principal residence the house or apartment which he was entitled to occupy as such stockholder.

(g) HUSBAND AND WIFE.—If the taxpayer and his spouse, in accordance with regulations which shall be prescribed by the Secretary pursuant to this subsection, consent to the application of paragraph (2) of this subsection, then—

(1) for purposes of this section—

(A) the taxpayer's adjusted sales price of the old residence is the adjusted sales price (of the taxpayer, or of the taxpayer and his spouse) of the old residence, and

(B) the taxpayer's cost of purchasing the new residence is the cost (to the taxpayer, his spouse, or both) of purchasing the new residence (whether held by the taxpayer, his spouse, or the taxpayer and his spouse); and

(2) so much of the gain on the sale of the old residence as is not recognized solely by reason of this subsection, and so much of the adjustment under subsection (e) to the basis of the new residence as results solely from this subsection shall be allocated between the taxpayer and his spouse as provided in such regulations.

This subsection shall apply only if the old residence and the new residence are each used by the taxpayer and his spouse as their principal residence. In case the taxpayer and his spouse do not consent to the application of paragraph (2) of this subsection then the recognition of gain on the sale of the old residence shall be determined under this section without regard to the rules provided in this subsection. For purposes of this subsection, except to the extent provided in regulations, in the case of an individual who dies after the date of the sale of the old residence and is married on the date of death, consent to the application of paragraph (2) by such individual's spouse and use of the new residence as the principal residence of such spouse shall be treated as consent and use by such individual.

(h) MEMBERS OF ARMED FORCES.—

(1) IN GENERAL.—The running of any period of time specified in subsection (a) or (c) (other than the 2 years referred to in subsection (c)(4)) shall be suspended during any time that the taxpayer (or his spouse if the old residence and the new residence are each used by the taxpayer and his spouse as their principal residence) serves on extended active duty with the Armed Forces of the United States after the date of the sale of the old residence, except that any such period of time as so suspended shall not extend beyond the date 4 years after the date of the sale of the old residence.

(2) MEMBERS STATIONED OUTSIDE THE UNITED STATES OR REQUIRED TO RESIDE IN GOVERNMENT QUARTERS.—In the case of any taxpayer who, during any period of time the running of which is suspended by paragraph (1)—

(A) is stationed outside of the United States, or

(B) after returning from a tour of duty outside of the United States and pursuant to a determination by the Secretary of Defense that adequate off-base housing is not available at a remote base site, is required to reside in on-base Government quarters,

any such period of time as so suspended shall not expire before the day which is 1 year after the last day described in subparagraph (A) or (B), as the case may be, except that any such period of time as so suspended shall not extend beyond the date which is 8 years after the date of the sale of the old residence.

(3) EXTENDED ACTIVE DUTY DEFINED.—For purposes of this subsection, the term "extended active duty" means any period of active duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period.

(i) SPECIAL RULE FOR CONDEMNATION.—In the case of the seizure, requisition, or condemnation of a residence, or the sale or exchange of a residence under threat or imminence thereof, the provisions of this section, in lieu of section 1033 (relating to involuntary conversions), shall be applicable if the taxpayer so elects. If such election is made, such seizure, requisition, or condemnation shall be treated as the sale of the residence. Such election shall be made at such time and in such manner as the Secretary shall prescribe by regulations.

(j) STATUTE OF LIMITATIONS.—If the taxpayer during a taxable year sells at a gain property used by him as his principal residence, then—

(1) the statutory period for the assessment of any deficiency attributable to any part of such gain shall not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may by regulations prescribe) of—

(A) the taxpayer's cost of purchasing the new residence which the taxpayer claims results in nonrecognition of any part of such gain,

(B) the taxpayer's intention not to purchase a new residence within the period specified in subsection (a), or

(C) a failure to make such purchase within such period; and

(2) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

(k) INDIVIDUAL WHOSE TAX HOME IS OUTSIDE THE UNITED STATES.—The running of any period of time specified in subsection (a) or (c) (other than the 2 years referred to in subsection (c)(4)) shall be suspended during any time that the taxpayer (or his spouse if the old residence and the new residence are each used by the taxpayer and his spouse as their principal residence) has a tax home (as defined in section 911(d)(3) outside the United States after the date of the sale of the old residence; except that any such period of time as so suspended shall not extend beyond the date 4 years after the date of the sale of the old residence.

(l) CROSS REFERENCE.—

For one-time exclusion from gross income of gain from sale of principal residence by individual who has attained age 55, see section 121.

The above amendment generally applies to sales and exchanges after May 6, 1997. For special rules, see Act Sec. 312(d)[(e)](2)-(4), below.

Act Sec. 312(d)[(e)](2)-(4) provides:

(2) SALES BEFORE DATE OF ENACTMENT.—At the election of the taxpayer, the amendments made by this section shall not apply to any sale or exchange before the date of the enactment of this Act.

(3) CERTAIN SALES WITHIN 2 YEARS AFTER DATE OF ENACTMENT.—Section 121 of the Internal Revenue Code of 1986 (as amended by this section) shall be applied without regard to subsection (c)(2)(B) thereof in the case of any sale or exchange of property during the 2-year period beginning on the date of the enactment of this Act if the taxpayer held such property on the date of the enactment of this Act and fails to meet the ownership and use requirements of subsection (a) thereof with respect to such property.

(4) BINDING CONTRACTS.—At the election of the taxpayer, the amendments made by this section shall not apply to a sale or exchange after the date of the enactment of this Act, if—

(A) such sale or exchange is pursuant to a contract which was binding on such date, or

(B) without regard to such amendments, gain would not be recognized under section 1034 of the Internal Revenue Code of 1986 (as in effect on the day before the date of the enactment of this Act) on such sale or exchange by reason of a new residence acquired on or before such date or with respect to the acquisition of which by the taxpayer a binding contract was in effect on such date.

This paragraph shall not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) of the Internal Revenue Code of 1986 applies to such individual.

[¶ 5325] CODE SEC. 1035. CERTAIN EXCHANGES OF INSURANCE POLICIES.

* * *

(c) EXCHANGES INVOLVING FOREIGN PERSONS.—To the extent provided in regulations, subsection (a) shall not apply to any exchange having the effect of transferring property to any person other than a United States person.

Amendment Notes

Act Sec. 1131(b)[(c)](1) amended Code Sec. 1035 by redesignating subsection (c) as subsection (d) and inserting after subsection (b) a new subsection (c) to read as above.

The above amendment is effective on the date of the enactment of this Act.

(d) CROSS REFERENCES.—

* * *

[CCH Explanation at ¶ 968 and 969. Committee Reports at ¶ 11,735.]

Amendment Notes

Act Sec. 1131(b)[(c)](1) amended Code Sec. 1035 by redesignating subsection (c) as subsection (d).

The above amendment is effective on the date of the enactment of this Act.

[¶ 5327] CODE SEC. 1036. STOCK FOR STOCK OF SAME CORPORATION.

* * *

(b) NONQUALIFIED PREFERRED STOCK NOT TREATED AS STOCK.—For purposes of this section, nonqualified preferred stock (as defined in section 351(g)(2)) shall be treated as property other than stock.

Amendment Notes

Act Sec. 1014(e)(3) amended Code Sec. 1036 by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) a new subsection (b) to read as above.

The above amendment generally applies to transactions after June 8, 1997. For a transition rule, see Act Sec. 1014(f)(2), below.

Act Sec. 1014(f)(2) provides:

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any transaction after June 8, 1997, if such transaction is—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the transaction.

(c) CROSS REFERENCES.—

* * *

[CCH Explanation at ¶ 507. Committee Reports at ¶ 11,180.]

Amendment Notes

Act Sec. 1014(e)(3) amended Code Sec. 1036 by redesignating subsection (b) as subsection (c).

The above amendment applies to transactions after June 8, 1997. For a transition rule, see Act Sec. 1014(f)(2) in the amendment notes following Code Sec. 1036(b).

[¶ 5329] CODE SEC. 1038. CERTAIN REACQUISITIONS OF REAL PROPERTY.

* * *

(e) PRINCIPAL RESIDENCES.—If—

(1) subsection (a) applies to a reacquisition of real property with respect to the sale of which gain was not recognized under section 121 (relating to gain on sale of principal residence); and

(2) within 1 year after the date of the reacquisition of such property by the seller, such property is resold by him,

then, under regulations prescribed by the Secretary, subsections (b), (c), and (d) of this section shall not apply to the reacquisition of such property and, for purposes of applying section 121, the resale of such property shall be treated as a part of the transaction constituting the original sale of such property.

* * *

[CCH Explanation at ¶ 129. Committee Reports at ¶ 10,315.]

Amendment Notes

Act Sec. 312(d)(8) amended Code Sec. 1038(e) to read as above. Prior to amendment, Code Sec. 1038(e) read as follows:

(e) PRINCIPAL RESIDENCES.—If—

(1) subsection (a) applies to a reacquisition of real property with respect to the sale of which—

(A) an election under section 121 (relating to one-time exclusion of gain from sale of principal residence by individual who has attained age 55) is in effect, or

(B) gain was not recognized under section 1034 (relating to rollover of gain on sale of principal residence); and

(2) within one year after the date of the reacquisition of such property by the seller, such property is resold by him,

then, under regulations prescribed by the Secretary, subsections (b), (c), and (d) of this section shall not apply to the reacquisition of such property and, for purposes of applying sections 121 and 1034, the resale of such property shall be treated as a part of the transaction constituting the original sale of such property.

The above amendment generally applies to sales and exchanges after May 6, 1997.

[Caution: Act Sec. 968 of the Taxpayer Relief Act of 1997 was canceled by President Clinton on August 11, 1997, pursuant to his authority under the Line Item Veto Act (P.L. 104-130). As we go to press, this provision is deemed to be stricken from the Act. However, under the procedures set out in P.L. 104-130 (or as the result of a successful challenge of its constitutionality), this provision may be reinstated at a later date.—CCH.]

[¶ 5331] CODE SEC. 1042. SALES OF STOCK TO EMPLOYEE STOCK OWNERSHIP PLANS OR CERTAIN COOPERATIVES.

* * *

(g) APPLICATION OF SECTION TO SALES OF STOCK IN AGRICULTURAL REFINERS AND PROCESSORS TO ELIGIBLE FARM COOPERATIVES.—

(1) IN GENERAL.—This section shall apply to the sale of stock of a qualified refiner or processor to an eligible farmers' cooperative.

(2) QUALIFIED REFINER OR PROCESSOR.—For purposes of this subsection, the term "qualified refiner or processor" means a domestic corporation—

(A) substantially all of the activities of which consist of the active conduct of the trade or business of refining or processing agricultural or horticultural products, and

(B) which, during the 1-year period ending on the date of the sale, purchases more than one-half of such products to be refined or processed from—

(i) farmers who make up the eligible farmers' cooperative which is purchasing stock in the corporation in a transaction to which this subsection is to apply, or

(ii) such cooperative.

(3) ELIGIBLE FARMERS' COOPERATIVE.—For purposes of this section, the term "eligible farmers' cooperative" means an organization to which part I of subchapter T applies and which is engaged in the marketing of agricultural or horticultural products.

(4) SPECIAL RULES.—In applying this section to a sale to which paragraph (1) applies—

(A) the eligible farmers' cooperative shall be treated in the same manner as a cooperative described in subsection (b)(1)(B),

(B) subsection (b)(2) shall be applied by substituting "100 percent" for "30 percent" each place it appears,

(C) the determination as to whether any stock in the domestic corporation is a qualified security shall be made without regard to whether the stock is an employer security or to subsection (c)(1)(A), and

(D) paragraphs (2)(D) and (7) of subsection (c) shall not apply.

* * *

[CCH Explanation at ¶ 369. Committee Reports at ¶ 10,870.]

Amendment Notes

Act Sec. 968(a) amended Code Sec. 1042 by adding at the end a new subsection (g) to read as above.

The above amendment applies to sales after December 31, 1997.

[¶ 5333] *CODE SEC. 1045. ROLLOVER OF GAIN FROM QUALIFIED SMALL BUSINESS STOCK TO ANOTHER QUALIFIED SMALL BUSINESS STOCK.*

(a) NONRECOGNITION OF GAIN.—In the case of any sale of qualified small business stock held by an individual for more than 6 months and with respect to which such individual elects the application of this section, gain from such sale shall be recognized only to the extent that the amount realized on such sale exceeds—

(1) the cost of any qualified small business stock purchased by the taxpayer during the 60-day period beginning on the date of such sale, reduced by

(2) any portion of such cost previously taken into account under this section.

This section shall not apply to any gain which is treated as ordinary income for purposes of this title.

(b) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) QUALIFIED SMALL BUSINESS STOCK.—The term "qualified small business stock" has the meaning given such term by section 1202(c).

(2) PURCHASE.—A taxpayer shall be treated as having purchased any property if, but for paragraph (3), the unadjusted basis of such property in the hands of the taxpayer would be its cost (within the meaning of section 1012).

(3) BASIS ADJUSTMENTS.—If gain from any sale is not recognized by reason of subsection (a), such gain shall be applied to reduce (in the order acquired) the basis for determining gain or loss of any qualified small business stock which is purchased by the taxpayer during the 60-day period described in subsection (a).

(4) HOLDING PERIOD.—For purposes of determining whether the nonrecognition of gain under subsection (a) applies to stock which is sold—

(A) the taxpayer's holding period for such stock and the stock referred to in subsection (a)(1) shall be determined without regard to section 1223, and

(B) only the first 6 months of the taxpayer's holding period for the stock referred to in subsection (a)(1) shall be taken into account for purposes of applying section 1202(c)(2).

* * *

[CCH Explanation at ¶ 306. Committee Reports at ¶ 10,320.]

Amendment Notes

Act Sec. 313(a) amended part III of subchapter O of chapter 1 by adding at the end a new Code Sec. 1045 to read as above.

The above amendment applies to sales after the date of enactment of this Act.

[¶ 5335] CODE SEC. 1057. ELECTION TO TREAT TRANSFER TO FOREIGN TRUST, ETC., AS TAXABLE EXCHANGE. *[REPEALED.]*

* * *

[CCH Explanation at ¶ 968 and 969. Committee Reports at ¶ 11,735.]

Amendment Notes

Act Sec. 1131(c)[(d)](2) repealed Code Sec. 1057. Prior to repeal, Code Sec. 1057 read as follows:

SEC. 1057. ELECTION TO TREAT TRANSFER TO FOREIGN TRUST, ETC., AS TAXABLE EXCHANGE.

In lieu of payment of the tax imposed by section 1491, the taxpayer may elect (for purposes of this subtitle), at such time and in such manner as the Secretary may prescribe, to treat a transfer described in section 1491 as a sale or exchange of property for an amount equal in value to the fair market value of the property transferred and to recognize as gain the excess of—

(1) the fair market value of the property so transferred, over

(2) the adjusted basis (for determining gain) of such property in the hands of the transferor.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5337] CODE SEC. 1059. CORPORATE SHAREHOLDER'S BASIS IN STOCK REDUCED BY NONTAXED PORTION OF EXTRAORDINARY DIVIDENDS.

(a) GENERAL RULE.—If any corporation receives any extraordinary dividend with respect to any share of stock and such corporation has not held such stock for more than 2 years before the dividend announcement date—

* * *

(2) AMOUNTS IN EXCESS OF BASIS.—If the nontaxed portion of such dividends exceeds such basis, such excess shall be treated as gain from the sale or exchange of such stock for the taxable year in which the extraordinary dividend is received.

* * *

Amendment Notes

Act Sec. 1011(a) amended Code Sec. 1059(a)(2) to read as above. Prior to amendment, Code Sec. 1059(a)(2) read as follows:

(2) RECOGNITION UPON SALE OR DISPOSITION IN CERTAIN CASES.—In addition to any gain recognized under this chapter, there shall be treated as gain from the sale or exchange of any stock for the taxable year in which the sale or disposition of such stock occurs an amount equal to the aggregate nontaxed portions of any extraordinary dividends with respect to such stock which did not reduce the basis of such stock by reason of the limitation on reducing basis below zero.

The above amendment generally applies to distributions after May 3, 1995. For special and transitional rules, see Act Sec. 1011(d)(2)-(3), below.

Act Sec. 1011(d)(2)-(3) provides:

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any distribution made pursuant to the terms of—

(A) a written binding contract in effect on May 3, 1995, and at all times thereafter before such distribution, or

(B) a tender offer outstanding on May 3, 1995.

(3) CERTAIN DIVIDENDS NOT PURSUANT TO CERTAIN REDEMPTIONS.—In determining whether the amendment made by subsection (a) applies to any extraordinary dividend other than a dividend treated as an extraordinary dividend under section 1059(e)(1) of the Internal Revenue Code of 1986 (as amended by this Act), paragraphs (1) and (2) shall be applied by substituting "September 13, 1995" for "May 3, 1995".

(d) SPECIAL RULES.—For purposes of this section—

(1) TIME FOR REDUCTION.—Any reduction in basis under subsection (a)(1) shall be treated as occurring at the beginning of the ex-dividend date of the extraordinary dividend to which the reduction relates.

* * *

(3) DETERMINATION OF HOLDING PERIOD.—For purposes of determining the holding period of stock under *subsection (a)*, rules similar to the rules of paragraphs (3) and (4) of section 246(c) shall apply; except that "2 years" shall be substituted for the number of days specified in subparagraph (B) of section 246(c)(3).

* * *

Amendment Notes

Act Sec. 1011(c) amended Code Sec. 1059(d)(1) to read as above. Prior to amendment, Code Sec. 1059(d)(1) read as follows:

(1) TIME FOR REDUCTION.—

(A) IN GENERAL.—Except as provided in subparagraph (B), any reduction in basis under subsection (a)(1) shall occur immediately before any sale or disposition of the stock.

(B) SPECIAL RULE FOR COMPUTING EXTRAORDINARY DIVIDEND.—In determining a taxpayer's adjusted basis for purposes of subsection (c)(1), any reduction in basis under subsection (a)(1) by reason of a prior distribution which was an extraordinary dividend shall be treated as occurring at the beginning of the ex-dividend date for such distribution.

The above amendment generally applies to distributions after May 3, 1995. For special and transitional rules, see Act Sec. 1011(d)(2)-(3) in the amendment notes following Code Sec. 1059(a), above.

Act Sec. 1604(d)(1) amended Code Sec. 1059(d)(3) by striking "subsection (a)(2)" and inserting "subsection (a)".

The above amendment is effective on the date of the enactment of this Act.

(e) SPECIAL RULES FOR CERTAIN DISTRIBUTIONS.—

(1) TREATMENT OF PARTIAL LIQUIDATIONS AND CERTAIN REDEMPTIONS.—Except as otherwise provided in regulations—

(A) REDEMPTIONS.—In the case of any redemption of stock—

(i) which is part of a partial liquidation (within the meaning of section 302(e)) of the redeeming corporation,

(ii) which is not pro rata as to all shareholders, or

(iii) which would not have been treated (in whole or in part) as a dividend if—

(I) any options had not been taken into account under section 318(a)(4), or

(II) section 304(a) had not applied,

any amount treated as a dividend with respect to such redemption shall be treated as an extraordinary dividend to which paragraphs (1) and (2) of subsection (a) apply without regard to the period the taxpayer held such stock. In the case of a redemption described in clause (iii), only the basis in the stock redeemed shall be taken into account under subsection (a).

(B) REORGANIZATIONS, ETC.—An exchange described in section 356 which is treated as a dividend shall be treated as a redemption of stock for purposes of applying subparagraph (A).

* * *

[CCH Explanation at ¶ 501 and 505. Committee Reports at ¶ 11,165 and 11,175.]

Amendment Notes

Act Sec. 1011(b) amended Code Sec. 1059(e)(1) to read as above. Prior to amendment, Code Sec. 1059(e)(1) read as follows:

(1) TREATMENT OF PARTIAL LIQUIDATIONS AND NON-PRO RATA REDEMPTIONS.—Except as otherwise provided in regulations, in the case of any redemption of stock which is—

(A) part of a partial liquidation (within the meaning of section 302(e)) of the redeeming corporation, or

(B) not pro rata as to all shareholders,

any amount treated as a dividend under section 301 with respect to such redemption shall be treated as an extraordinary dividend to which paragraphs (1) and (2) of subsection (a) apply without regard to the period the taxpayer held such stock.

The above amendment generally applies to distributions after May 3, 1995. For special and transitional rules, see Act Sec. 1011(d)(2)-(3) in the amendment notes following Code Sec. 1059(a), above.

Act Sec. 1013(b) amended Code Sec. 1059(e)(1)(A)(iii), as amended by Act Sec. 1011(b), to read as above. Prior to amendment, Code Sec. 1059(e)(1)(A)(iii) read as follows:

(iii) which would not have been treated (in whole or in part) as a dividend if any options had not been taken into account under section 318(a)(4),

The above amendment applies to distributions and acquisitions after June 8, 1997. For a transition rule, see Act Sec. 1013(d)(2), below.

Act Sec. 1013(d)(2), provides:

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any distribution or acquisition after June 8, 1997, if such distribution or acquisition is—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described in a public announcement or filing with the Securities and Exchange Commission on or before such date.

[¶ 5339] CODE SEC. 1092. STRADDLES.

* * *

(f) TREATMENT OF GAIN OR LOSS AND SUSPENSION OF HOLDING PERIOD WHERE TAXPAYER GRANTOR OF QUALIFIED COVERED CALL OPTION.—If a taxpayer holds any stock and grants a qualified covered call option to purchase such stock with a strike price less than the applicable stock price—

* * *

(2) SUSPENSION OF HOLDING PERIOD.—*The* holding period of such stock shall not include any period during which the taxpayer is the grantor of such option.

* * *

[CCH Explanation at ¶ 535. Committee Reports at ¶ 12,515.]

Amendment Notes

Act Sec. 1271(b)(9) amended Code Sec. 1092(f)(2) by striking "Except for purposes of section 851(b)(3), the" and inserting "The".

The above amendment applies to tax years beginning after the date of the enactment of this Act.

[¶ 5341] CODE SEC. 1201. ALTERNATIVE TAX FOR CORPORATIONS.

(a) GENERAL RULE.—If for any taxable year a corporation has a net capital gain and any rate of tax imposed by section 11, 511, or 831(a) or (b) (whichever is applicable) exceeds 35 percent (determined without regard to the last 2 sentences of section 11(b)(1)), then, in lieu of any such tax, there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

(1) a tax computed on the taxable income reduced by the amount of the net capital gain, at the rates and in the manner as if this subsection had not been enacted, plus

(2) a tax of 35 percent of the net capital gain *(or, if less, taxable income).*

* * *

[CCH Explanation at ¶ 305. Committee Reports at ¶ 10,325.]

Amendment Notes

Act Sec. 314(a) amended Code Sec. 1201(a)(2) by inserting before the period "(or, if less, taxable income)".

The above amendment applies to tax years ending after December 31, 1997.

[¶ 5343] CODE SEC. 1223. HOLDING PERIOD OF PROPERTY.

For purposes of this subtitle—

* * *

(7) In determining the period for which the taxpayer has held a residence, the acquisition of which resulted under section 1034 *(as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997)* in the nonrecognition of any part of the gain realized on the sale or exchange of another residence, there shall be included the period for which such other residence had been held as of the date of such sale or exchange. For purposes of this paragraph, the term "sale or exchange" includes an involuntary conversion occurring after December 31, 1950, and before January 1, 1954.

* * *

(15) In determining the period for which the taxpayer has held property the acquisition of which resulted under section 1045 in the nonrecognition of any part of the gain realized on the sale of other property, there shall be included the period for which such other property has been held as of the date of such sale.

(16) CROSS REFERENCE.—

For special holding period provision relating to certain partnership distributions, see section 735(b).

* * *

[CCH Explanation at ¶ 129 and 306. Committee Reports at ¶ 10,315 and 10,320.]

Amendment Notes

Act Sec. 312(d)(9) amended Code Sec. 1223(7) by inserting "(as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997)" after "1034".

The above amendment generally applies to sales and exchanges after May 6, 1997.

Act Sec. 313(b)(2) amended Code Sec. 1223 by redesignating paragraph (15) as paragraph (16) and by inserting after paragraph (14) a new paragraph (15) to read as above.

The above amendment applies to sales after the date of enactment of this Act.

[¶ 5345] CODE SEC. 1233. GAINS AND LOSSES FROM SHORT SALES.

* * *

(h) SHORT SALES OF PROPERTY WHICH BECOMES SUBSTANTIALLY WORTHLESS.—

(1) IN GENERAL.—If—

(A) the taxpayer enters into a short sale of property, and

(B) such property becomes substantially worthless,

the taxpayer shall recognize gain in the same manner as if the short sale were closed when the property becomes substantially worthless. To the extent provided in regulations prescribed by the Secretary, the preceding sentence also shall apply with respect to any option with respect to property, any offsetting notional principal contract with respect to property, any futures or forward contract to deliver any property, and any other similar transaction.

(2) STATUTE OF LIMITATIONS.—If property becomes substantially worthless during a taxable year and any short sale of such property remains open at the time such property becomes substantially worthless, then—

(A) the statutory period for the assessment of any deficiency attributable to any part of the gain on such transaction shall not expire before the earlier of—

(i) the date which is 3 years after the date the Secretary is notified by the taxpayer (in such manner as the Secretary may by regulations prescribe) of the substantial worthlessness of such property, or

(ii) the date which is 6 years after the date the return for such taxable year is filed, and

(B) such deficiency may be assessed before the date applicable under subparagraph (A) notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

* * *

[CCH Explanation at ¶ 307. Committee Reports at ¶ 11,130.]

Amendment Notes

Act Sec. 1003(b)(1) amended Code Sec. 1233 by adding a new subsection (h) to read as above.

The above amendment applies to property which becomes substantially worthless after the date of the enactment of this Act.

[¶ 5347] CODE SEC. 1234A. GAINS OR LOSSES FROM CERTAIN TERMINATIONS.

Gain or loss attributable to the cancellation, lapse, expiration, or other termination of—

(1) a right or obligation with respect to *property* which is (or on acquisition would be) a capital asset in the hands of the taxpayer, or

(2) a section 1256 contract (as defined in section 1256) not described in paragraph (1) which is a capital asset in the hands of the taxpayer,

shall be treated as gain or loss from the sale of a capital asset. The preceding sentence shall not apply to the retirement of any debt instrument (whether or not through a trust or other participation arrangement).

* * *

[CCH Explanation at ¶ 307. Committee Reports at ¶ 11,130.]

Amendment Notes

Act Sec. 1003(a)(1) amended Code Sec. 1234A(1) by striking "personal property (as defined in section 1092(d)(1))" and inserting "property".

The above amendment applies to terminations more than 30 days after the date of the enactment of this Act.

[¶ 5349] CODE SEC. 1239. GAIN FROM SALE OF DEPRECIABLE PROPERTY BETWEEN CERTAIN RELATED TAXPAYERS.

* * *

(b) Related Persons.—For purposes of subsection (a), the term "related persons" means—

(1) a person and all entities which are controlled entities with respect to such person,

(2) a taxpayer and any trust in which such taxpayer (or his spouse) is a beneficiary, unless such beneficiary's interest in the trust is a remote contingent interest (within the meaning of section 318(a)(3)(B)(i)), *and*

(3) except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.

* * *

[CCH Explanation at ¶ 270. Committee Reports at ¶ 12,650.]

Amendment Notes

Act Sec. 1308(b) amended Code Sec. 1239(b) by striking the period at the end of paragraph (2) and inserting ", and" and by adding at the end a new paragraph (3) to read as above.

The above amendment applies to tax years beginning after the date of the enactment of this Act.

[¶ 5351] CODE SEC. 1245. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE PROPERTY.

(a) General Rule.—

* * *

(2) Recomputed basis.—For purposes of this section—

* * *

(C) Certain deductions treated as amortization.—Any deduction allowable under section 179, *179A*, 190, or 193 shall be treated as if it were a deduction allowable for amortization.

(3) Section 1245 property.—For purposes of this section, the term "section 1245 property" means any property which is or has been property of a character subject to the allowance for depreciation provided in section 167 and is either—

(A) personal property,

(B) other property (not including a building or its structural components) but only if such other property is tangible and has an adjusted basis in which there are reflected adjustments described in paragraph (2) for a period in which such property (or other property)—

(i) was used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

(ii) constituted a research facility used in connection with any of the activities referred to in clause (i), or

(iii) constituted a facility used in connection with any of the activities referred to in clause (i) for the bulk storage of fungible commodities (including commodities in a liquid or gaseous state),

(C) so much of any real property (other than any property described in subparagraph B)) which has an adjusted basis in which there are reflected adjustments for amortization under

section 169, 179, 179A, 185, 188 (as in effect before its repeal by the Revenue Reconciliation Act of 1990), 190, 193, or 194.

(D) a single purpose agricultural or horticultural structure (as defined in section 168(i)(13),

(E) a storage facility (not including a building or its structural components) used in connection with the distribution of petroleum or any primary product of petroleum, or

(F) any railroad grading or tunnel bore (as defined in section 168(e)(4)).

* * *

Amendment Notes

Act Sec. 1604(a)(1) amended Code Sec. 1245(a)(2)(C) and (3)(C) by inserting "179A," after "179,".

The above amendment is effective as if included in the amendments made by Act Sec. 1913 of the Energy Policy Act of 1992 (P.L. 102-486) [effective for property placed in service after June 30, 1993.—CCH.].

[¶ 5353] CODE SEC. 1250. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY.

* * *

(d) EXCEPTIONS AND LIMITATIONS.—

* * *

(7) TRANSFERS TO TAX-EXEMPT ORGANIZATION WHERE PROPERTY WILL BE USED IN UNRELATED BUSINESS.—

* * *

(8) FORECLOSURE DISPOSITIONS.—If any section 1250 property is disposed of by the taxpayer pursuant to a bid for such property at foreclosure or by operation of an agreement or of process of law after there was a default on indebtedness which such property secured, the applicable percentage referred to in paragraph (1)(B), (2)(B), or (3)(B) of subsection (a), as the case may be, shall be determined as if the taxpayer ceased to hold such property on the date of the beginning of the proceedings pursuant to which the disposition occurred, or, in the event there are no proceedings, such percentage shall be determined as if the taxpayer ceased to hold such property on the date, determined under regulations prescribed by the Secretary, on which such operation of an agreement or process of law, pursuant to which the disposition occurred, began.

Amendment Notes

Act Sec. 312(d)(10)(A) amended Code Sec. 1250(d) by striking paragraph (7) and by redesignating paragraphs (9) and (10) as paragraphs (7) and (8), respectively. Prior to amendment, Code Sec. 1250(d)(7) read as follows:

(7) DISPOSITIONS OF PRINCIPAL RESIDENCE.—Subsection (a) shall not apply to a disposition of—

(A) property to the extent used by the taxpayer as his principal residence (within the meaning of section 1034, relating to rollover of gain on sale of principal residence), and

(B) property in respect of which the taxpayer meets the age and ownership requirements of section 121 (relating to one-time exclusion of gain from sale of principal residence by individual who has attained age 55) but only to the extent that he meets the use requirements of such section in respect of such property.

The above amendment generally applies to sales and exchanges after May 6, 1997.

(e) HOLDING PERIOD.—For purposes of determining the applicable percentage under this section, the provisions of section 1223 shall not apply, and the holding period of section 1250 property shall be determined under the following rules:

* * *

(3) *[Stricken.]*

* * *

[CCH Explanation at ¶ 129. Committee Reports at ¶ 10,315.]

Amendment Notes

Act Sec. 312(d)(10)(B) amended Code Sec. 1250(e) by striking paragraph (3). Prior to being stricken, paragraph Code Sec. 1250(e)(3) read as follows:

(3) PRINCIPAL RESIDENCE.—If the basis of property acquired in a transaction described in paragraph (7) of subsection (d) is determined by reference to the basis in the hands of the taxpayer of other property, then the holding period of the property acquired shall include the holding period of such other property.

The above amendment generally applies to sales and exchanges after May 6, 1997.

[¶ 5355] *CODE SEC. 1259. CONSTRUCTIVE SALES TREATMENT FOR APPRECIATED FINANCIAL POSITIONS.*

(a) IN GENERAL.—If there is a constructive sale of an appreciated financial position—

(1) the taxpayer shall recognize gain as if such position were sold, assigned, or otherwise terminated at its fair market value on the date of such constructive sale (and any gain shall be taken into account for the taxable year which includes such date), and

(2) for purposes of applying this title for periods after the constructive sale—

(A) proper adjustment shall be made in the amount of any gain or loss subsequently realized with respect to such position for any gain taken into account by reason of paragraph (1), and

(B) the holding period of such position shall be determined as if such position were originally acquired on the date of such constructive sale.

(b) APPRECIATED FINANCIAL POSITION.—For purposes of this section—

(1) IN GENERAL.—Except as provided in paragraph (2), the term "appreciated financial position" means any position with respect to any stock, debt instrument, or partnership interest if there would be gain were such position sold, assigned, or otherwise terminated at its fair market value.

(2) EXCEPTIONS.—The term "appreciated financial position" shall not include—

(A) any position with respect to debt if—

(i) the debt unconditionally entitles the holder to receive a specified principal amount,

(ii) the interest payments (or other similar amounts) with respect to such debt meet the requirements of clause (i) of section 860G(a)(1)(B), and

(iii) such debt is not convertible (directly or indirectly) into stock of the issuer or any related person, and

(B) any position which is marked to market under any provision of this title or the regulations thereunder.

(3) POSITION.—The term "position" means an interest, including a futures or forward contract, short sale, or option.

(c) CONSTRUCTIVE SALE.—For purposes of this section—

(1) IN GENERAL.—A taxpayer shall be treated as having made a constructive sale of an appreciated financial position if the taxpayer (or a related person)—

(A) enters into a short sale of the same or substantially identical property,

(B) enters into an offsetting notional principal contract with respect to the same or substantially identical property,

(C) enters into a futures or forward contract to deliver the same or substantially identical property,

(D) in the case of an appreciated financial position that is a short sale or a contract described in subparagraph (B) or (C) with respect to any property, acquires the same or substantially identical property, or

(E) to the extent prescribed by the Secretary in regulations, enters into 1 or more other transactions (or acquires 1 or more positions) that have substantially the same effect as a transaction described in any of the preceding subparagraphs.

(2) EXCEPTION FOR SALES OF NONPUBLICLY TRADED PROPERTY.—The term "constructive sale" shall not include any contract for sale of any stock, debt instrument, or partnership interest which is not a marketable security (as defined in section 453(f)) if the contract settles within 1 year after the date such contract is entered into.

(3) EXCEPTION FOR CERTAIN CLOSED TRANSACTIONS.—

(A) IN GENERAL.—In applying this section, there shall be disregarded any transaction (which would otherwise be treated as a constructive sale) during the taxable year if—

(i) such transaction is closed before the end of the 30th day after the close of such taxable year,

(ii) the taxpayer holds the appreciated financial position throughout the 60-day period beginning on the date such transaction is closed, and

(iii) at no time during such 60-day period is the taxpayer's risk of loss with respect to such position reduced by reason of a circumstance which would be described in section 246(c)(4) if references to stock included references to such position.

(B) TREATMENT OF POSITIONS WHICH ARE REESTABLISHED.—If—

(i) a transaction, which would otherwise be treated as a constructive sale of an appreciated financial position, is closed during the taxable year or during the 30 days thereafter, and

(ii) another substantially similar transaction is entered into during the 60-day period beginning on the date the transaction referred to in clause (i) is closed—

(I) which also would otherwise be treated as a constructive sale of such position,

(II) which is closed before the 30th day after the close of the taxable year in which the transaction referred to in clause (i) occurs, and

(III) which meets the requirements of clauses (ii) and (iii) of subparagraph (A),

the transaction referred to in clause (ii) shall be disregarded for purposes of determining whether the requirements of subparagraph (A)(iii) are met with respect to the transaction described in clause (i).

(4) RELATED PERSON.—A person is related to another person with respect to a transaction if—

(A) the relationship is described in section 267(b) or 707(b), and

(B) such transaction is entered into with a view toward avoiding the purposes of this section.

(d) OTHER DEFINITIONS.—For purposes of this section—

(1) FORWARD CONTRACT.—The term "forward contract" means a contract to deliver a substantially fixed amount of property for a substantially fixed price.

(2) OFFSETTING NOTIONAL PRINCIPAL CONTRACT.—The term "offsetting notional principal contract" means, with respect to any property, an agreement which includes—

(A) a requirement to pay (or provide credit for) all or substantially all of the investment yield (including appreciation) on such property for a specified period, and

(B) a right to be reimbursed for (or receive credit for) all or substantially all of any decline in the value of such property.

(e) SPECIAL RULES.—

(1) TREATMENT OF SUBSEQUENT SALE OF POSITION WHICH WAS DEEMED SOLD.—If—

(A) there is a constructive sale of any appreciated financial position,

(B) such position is subsequently disposed of, and

(C) at the time of such disposition, the transaction resulting in the constructive sale of such position is open with respect to the taxpayer or any related person,

solely for purposes of determining whether the taxpayer has entered into a constructive sale of any other appreciated financial position held by the taxpayer, the taxpayer shall be treated as entering into such transaction immediately after such disposition. For purposes of the preceding sentence, an assignment or other termination shall be treated as a disposition.

(2) CERTAIN TRUST INSTRUMENTS TREATED AS STOCK.—For purposes of this section, an interest in a trust which is actively traded (within the meaning of section 1092(d)(1)) shall be treated as stock unless substantially all (by value) of the property held by the trust is debt described in subsection (b)(2)(A).

(3) MULTIPLE POSITIONS IN PROPERTY.—If a taxpayer holds multiple positions in property, the determination of whether a specific transaction is a constructive sale and, if so, which appreciated financial position is deemed sold shall be made in the same manner as actual sales.

(f) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

[CCH Explanation at ¶ 308, 309, 310, 311 and 312. Committee Reports at ¶ 11,115.]

Amendment Notes

Act Sec. 1001(a) amended part IV of subchapter P of chapter 1 by adding at the end a new Code Sec. 1259 to read as above.

The above amendment generally applies to any constructive sale after June 8, 1997. For special rules, see Act Sec. 1001(d)(2)-(4), below.

Act Sec. 1001(d)(2)-(4) provides:

(2) EXCEPTION FOR SALES OF POSITIONS, ETC. HELD BEFORE JUNE 9, 1997.—If—

(A) before June 9, 1997, the taxpayer entered into any transaction which is a constructive sale of any appreciated financial position, and

(B) before the close of the 30-day period beginning on the date of the enactment of this Act or before such later date as may be specified by the Secretary of the Treasury,

such transaction and position are clearly identified in the taxpayer's records as offsetting, such transaction and position shall not be taken into account in determining whether any other constructive sale after June 8, 1997, has occurred. The preceding sentence shall cease to apply as of the date

such transaction is closed or the taxpayer ceases to hold such position.

(3) SPECIAL RULE.—In the case of a decedent dying after June 8, 1997, if—

(A) there was a constructive sale on or before such date of any appreciated financial position,

(B) the transaction resulting in such constructive sale of such position remains open (with respect to the decedent or any related person)—

(i) for not less than 2 years after the date of such transaction (whether such period is before or after June 8, 1997), and

(ii) at any time during the 3-year period ending on the date of the decedent's death, and

(C) such transaction is not closed within the 30-day period beginning on the date of the enactment of this Act,

then, for purposes of such Code, such position (and the transaction resulting in such constructive sale) shall be treated as property constituting rights to receive an item of income in respect of a decedent under section 691 of such Code. Section 1014(c) of such Code shall not apply to so much of such position's or property's value (as included in the decedent's estate for purposes of chapter 11 of such Code) as exceeds its fair market value as of the date such transaction is closed.

(4) ELECTION OF MARK TO MARKET BY SECURITIES TRADERS AND TRADERS AND DEALERS IN COMMODITIES.—

(A) IN GENERAL.—The amendments made by subsection (b) shall apply to taxable years ending after the date of the enactment of this Act.

(B) 4-YEAR SPREAD OF ADJUSTMENTS.—In the case of a taxpayer who elects under subsection (e) or (f) of section 475 of the Internal Revenue Code of 1986 (as added by this section) to change its method of accounting for the taxable year which includes the date of the enactment of this Act—

(i) any identification required under such subsection with respect to securities and commodities held on the date of the enactment of this Act shall be treated as timely made if made on or before the 30th day after such date of enactment, and

(ii) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of such Code shall be taken into account ratably over the 4-taxable year period beginning with such first taxable year.

[¶ 5357] CODE SEC. 1271. TREATMENT OF AMOUNTS RECEIVED ON RETIREMENT OR SALE OR EXCHANGE OF DEBT INSTRUMENTS.

* * *

(b) EXCEPTION FOR CERTAIN OBLIGATIONS.—

(1) IN GENERAL.—This section shall not apply to—

(A) any obligation issued by a natural person before June 9, 1997, and

(B) any obligation issued before July 2, 1982, by an issuer which is not a corporation and is not a government or political subdivision thereof.

(2) TERMINATION.—Paragraph (1) shall not apply to any obligation purchased (within the meaning of section 1272(d)(1)) after June 8, 1997.

* * *

[CCH Explanation at ¶ 307. Committee Reports at ¶ 11,130.]

Amendment Notes

Act Sec. 1003(c)(1) amended Code Sec. 1271(b) to read as above. Prior to amendment, Code Sec. 1271(b) read as follows:

(b) EXCEPTIONS.—This section shall not apply to—

(1) NATURAL PERSONS.—Any obligation issued by a natural person.

(2) OBLIGATIONS ISSUED BEFORE JULY 2, 1982, BY CERTAIN ISSUERS.—Any obligation issued before July 2, 1982, by an issuer which—

(A) is not a corporation, and

(B) is not a government or political subdivision thereof.

The above amendment applies to sales, exchanges, and retirements after the date of the enactment of this Act.

[¶ 5359] CODE SEC. 1272. CURRENT INCLUSION IN INCOME OF ORIGINAL ISSUE DISCOUNT.

(a) ORIGINAL ISSUE DISCOUNT ON DEBT INSTRUMENTS ISSUED AFTER JULY 1, 1982, INCLUDED IN INCOME ON BASIS OF CONSTANT INTEREST RATE.—

* * *

(6) DETERMINATION OF DAILY PORTIONS WHERE PRINCIPAL SUBJECT TO ACCELERATION.—

* * *

(C) DEBT INSTRUMENTS TO WHICH PARAGRAPH APPLIES.—This paragraph applies to—

(i) any regular interest in a REMIC or qualified mortgage held by a REMIC,

(ii) any other debt instrument if payments under such debt instrument may be accelerated by reason of prepayments of other obligations securing such debt instrument (or, to the extent provided in regulations, by reason of other events), *or*

(iii) any pool of debt instruments the yield on which may be affected by reason of prepayments (or to the extent provided in regulations, by reason of other events).

To the extent provided in regulations prescribed by the Secretary, in the case of a small business engaged in the trade or business of selling tangible personal property at retail, clause (iii) shall

not apply to debt instruments incurred in the ordinary course of such trade or business while held by such business.

* * *

[CCH Explanation at ¶ 345. Committee Reports at ¶ 11,135.]

Amendment Notes

Act Sec. 1004(a) amended Code Sec. 1272(a)(6)(C) by striking "or" at the end of clause (i), by striking the period at the end of clause (ii) and inserting ", or", and by inserting after clause (ii) a new clause (iii) and a new flush sentence to read as above.

The above amendment generally applies to tax years beginning after the date of enactment of this Act. For a special rule, see Act Sec. 1004(b)(2)(A)-(C), below.

Act Sec. 1004(b)(2)(A)-(C) provides:

(2) CHANGE IN METHOD OF ACCOUNTING.—In the case of any taxpayer required by this section to change its method of accounting for its first taxable year beginning after the date of the enactment of this Act—

(A) such change shall be treated as initiated by the taxpayer,

(B) such change shall be treated as made with the consent of the Secretary of the Treasury, and

(C) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of the Internal Revenue Code of 1986 shall be taken into account ratably over the 4-taxable year period beginning with such first taxable year.

[¶ 5361] CODE SEC. 1274. DETERMINATION OF ISSUE PRICE IN THE CASE OF CERTAIN DEBT INSTRUMENTS ISSUED FOR PROPERTY.

* * *

(c) DEBT INSTRUMENTS TO WHICH SECTION APPLIES.—

* * *

(3) EXCEPTIONS.—This section shall not apply to—

* * *

(B) SALES OF PRINCIPAL RESIDENCES.—Any debt instrument arising from the sale or exchange by an individual of his principal residence (within the meaning of *section 121*).

* * *

[CCH Explanation at ¶ 129. Committee Reports at ¶ 10,315.]

Amendment Notes

Act Sec. 312(d)(1) amended Code Sec. 1274(c)(3)(B) by striking "section 1034" and inserting "section 121".

The above amendment generally applies to sales and exchanges after May 6, 1997.

[¶ 5363] CODE SEC. 1291. INTEREST ON TAX DEFERRAL.

(a) TREATMENT OF DISTRIBUTIONS AND STOCK DISPOSITIONS.—

* * *

(3) DEFINITIONS.—For purposes of this section—

(A) HOLDING PERIOD.—The taxpayer's holding period shall be determined under section 1223; except that—

(i) for purposes of applying this section to an excess distribution, such holding period shall be treated as ending on the date of such distribution, and

(ii) if section 1296 applied to such stock with respect to the taxpayer for any prior taxable year, such holding period shall be treated as beginning on the first day of the first taxable year beginning after the last taxable year for which section 1296 so applied.

* * *

Amendment Notes

Act Sec. 1122(b)(3) amended Code Sec. 1291(a)(3)(A) to read as above. Prior to amendment, Code Sec. 1291(a)(3)(A) read as follows:

(A) HOLDING PERIOD.—The taxpayer's holding period shall be determined under section 1223; except that, for purposes of applying this section to an excess distribution, such holding period shall be treated as ending on the date of such distribution.

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and tax years of foreign corporations ending with or within such tax years of United States persons.

(d) COORDINATION WITH *SUBPARTS B AND C*.—

(1) IN GENERAL.—This section shall not apply with respect to any distribution paid by a passive foreign investment company, or any disposition of stock in a passive foreign investment company, if such company is a qualified electing fund with respect to the taxpayer for each of its taxable years—

(A) which begins after December 31, 1986, and for which such company is a passive foreign investment company, and

(B) which includes any portion of the taxpayer's holding period.

Except as provided in section 1296(j), this section also shall not apply if an election under section 1296(k) is in effect for the taxpayer's taxable year.

* * *

[CCH Explanation at ¶ 946. Committee Reports at ¶ 11,690.]

Amendment Notes

Act Sec. 1122(b)(1) amended Code Sec. 1291(d)(1) by adding at the end a new flush sentence to read as above.

Act Sec. 1122(b)(2) amended Code Sec. 1291(d) by striking "SUBPART B" in the heading and inserting "SUBPARTS B AND C".

The above amendments apply to tax years of United States persons beginning after December 31, 1997, and tax years of foreign corporations ending with or within such tax years of United States persons.

[¶ 5365] CODE SEC. 1293. CURRENT TAXATION OF INCOME FROM QUALIFIED ELECTING FUNDS.

(a) INCLUSION.—

(1) IN GENERAL.—Every United States person who owns (or is treated under *section 1298(a)* as owning) stock of a qualified electing fund at any time during the taxable year of such fund shall include in gross income—

(A) as ordinary income, such shareholder's pro rata share of the ordinary earnings of such fund for such year, and

(B) as long-term capital gain, such shareholder's pro rata share of the net capital gain of such fund for such year.

* * *

Amendment Notes

Act Sec. 1122(d)(3) amended Code Sec. 1293(a)(1) by striking "section 1297(a)" and inserting "section 1298(a)".

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and tax years of foreign corporations ending with or within such tax years of United States persons.

(d) BASIS ADJUSTMENTS.—The basis of taxpayer's stock in a passive foreign investment company shall be—

(1) increased by any amount which is included in the income of the taxpayer under subsection (a) with respect to such stock, and

(2) decreased by any amount distributed with respect to such stock which is not includible in the income of the taxpayer by reason of subsection (c).

A similar rule shall apply also in the case of any property if by reason of holding such property the taxpayer is treated under *section 1298(a)* as owning stock in a qualified electing fund.

* * *

[CCH Explanation at ¶ 946. Committee Reports at ¶ 11,690.]

Amendment Notes

Act Sec. 1122(d)(3) amended Code Sec. 1293(d) by striking "section 1297(a)" and inserting "section 1298(a)".

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and tax years of foreign corporations ending with or within such tax years of United States persons.

[¶ 5367] *CODE SEC. 1296. ELECTION OF MARK TO MARKET FOR MARKETABLE STOCK.*

(a) GENERAL RULE.—In the case of marketable stock in a passive foreign investment company which is owned (or treated under subsection (g) as owned) by a United States person at the close of any taxable year of such person, at the election of such person—

(1) If the fair market value of such stock as of the close of such taxable year exceeds its adjusted basis, such United States person shall include in gross income for such taxable year an amount equal to the amount of such excess.

(2) If the adjusted basis of such stock exceeds the fair market value of such stock as of the close of such taxable year, such United States person shall be allowed a deduction for such taxable year equal to the lesser of—

(A) the amount of such excess, or

(B) the unreversed inclusions with respect to such stock.

(b) Basis Adjustments.—

(1) In general.—The adjusted basis of stock in a passive foreign investment company—

(A) shall be increased by the amount included in the gross income of the United States person under subsection (a)(1) with respect to such stock, and

(B) shall be decreased by the amount allowed as a deduction to the United States person under subsection (a)(2) with respect to such stock.

(2) Special rule for stock constructively owned.—In the case of stock in a passive foreign investment company which the United States person is treated as owning under subsection (g)—

(A) the adjustments under paragraph (1) shall apply to such stock in the hands of the person actually holding such stock but only for purposes of determining the subsequent treatment under this chapter of the United States person with respect to such stock, and

(B) similar adjustments shall be made to the adjusted basis of the property by reason of which the United States person is treated as owning such stock.

(c) Character and Source Rules.—

(1) Ordinary treatment.—

(A) Gain.—Any amount included in gross income under subsection (a)(1), and any gain on the sale or other disposition of marketable stock in a passive foreign investment company (with respect to which an election under this section is in effect), shall be treated as ordinary income.

(B) Loss.—Any—

(i) amount allowed as a deduction under subsection (a)(2), and

(ii) loss on the sale or other disposition of marketable stock in a passive foreign investment company (with respect to which an election under this section is in effect) to the extent that the amount of such loss does not exceed the unreversed inclusions with respect to such stock,

shall be treated as an ordinary loss. The amount so treated shall be treated as a deduction allowable in computing adjusted gross income.

(2) Source.—The source of any amount included in gross income under subsection (a)(1) (or allowed as a deduction under subsection (a)(2)) shall be determined in the same manner as if such amount were gain or loss (as the case may be) from the sale of stock in the passive foreign investment company.

(d) Unreversed Inclusions.—For purposes of this section, the term "unreversed inclusions" means, with respect to any stock in a passive foreign investment company, the excess (if any) of—

(1) the amount included in gross income of the taxpayer under subsection (a)(1) with respect to such stock for prior taxable years, over

(2) the amount allowed as a deduction under subsection (a)(2) with respect to such stock for prior taxable years.

The amount referred to in paragraph (1) shall include any amount which would have been included in gross income under subsection (a)(1) with respect to such stock for any prior taxable year but for section 1291.

(e) Marketable Stock.—For purposes of this section—

(1) In general.—The term "marketable stock" means—

(A) any stock which is regularly traded on—

(i) a national securities exchange which is registered with the Securities and Exchange Commission or the national market system established pursuant to section 11A of the Securities and Exchange Act of 1934, or

(ii) any exchange or other market which the Secretary determines has rules adequate to carry out the purposes of this part,

(B) to the extent provided in regulations, stock in any foreign corporation which is comparable to a regulated investment company and which offers for sale or has outstanding any stock of which it is the issuer and which is redeemable at its net asset value, and

(C) to the extent provided in regulations, any option on stock described in subparagraph (A) or (B).

(2) Special rule for regulated investment companies.—In the case of any regulated investment company which is offering for sale or has outstanding any stock of which it is the issuer and which is redeemable at its net asset value, all stock in a passive foreign investment company which it owns directly or indirectly shall be treated as marketable stock for purposes of this section. Except as provided in regulations, similar treatment as marketable stock shall apply in the case of any other regulated investment company which publishes net asset valuations at least annually.

(f) Treatment of Controlled Foreign Corporations Which Are Shareholders in Passive Foreign Investment Companies.—In the case of a foreign corporation which is a controlled foreign corporation and which owns (or is treated under subsection (g) as owning) stock in a passive foreign investment company—

(1) this section (other than subsection (c)(2)) shall apply to such foreign corporation in the same manner as if such corporation were a United States person, and

(2) for purposes of subpart F of part III of subchapter N—

(A) any amount included in gross income under subsection (a)(1) shall be treated as foreign personal holding company income described in section 954(c)(1)(A), and

(B) any amount allowed as a deduction under subsection (a)(2) shall be treated as a deduction allocable to foreign personal holding company income so described.

(g) Stock Owned Through Certain Foreign Entities.—Except as provided in regulations—

(1) In general.—For purposes of this section, stock owned, directly or indirectly, by or for a foreign partnership or foreign trust or foreign estate shall be considered as being owned proportionately by its partners or beneficiaries. Stock considered to be owned by a person by reason of the application of the preceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person.

(2) Treatment of certain dispositions.—In any case in which a United States person is treated as owning stock in a passive foreign investment company by reason of paragraph (1)—

(A) any disposition by the United States person or by any other person which results in the United States person being treated as no longer owning such stock, and

(B) any disposition by the person owning such stock,

shall be treated as a disposition by the United States person of the stock in the passive foreign investment company.

(h) Coordination With Section 851(b).—For purposes of paragraphs (2) and (3) of section 851(b), any amount included in gross income under subsection (a) shall be treated as a dividend.

(i) Stock acquired from a decedent.—In the case of stock of a passive foreign investment company which is acquired by bequest, devise, or inheritance (or by the decedent's estate) and with respect to which an election under this section was in effect as of the date of the decedent's death, notwithstanding section 1014, the basis of such stock in the hands of the person so acquiring it shall be the adjusted basis of such stock in the hands of the decedent immediately before his death (or, if lesser, the basis which would have been determined under section 1014 without regard to this subsection).

(j) Coordination With Section 1291 For First Year of Election.—

(1) Taxpayers other than regulated investment companies.—

(A) In general.—If the taxpayer elects the application of this section with respect to any marketable stock in a corporation after the beginning of the taxpayer's holding period in such stock, and if the requirements of subparagraph (B) are not satisfied, section 1291 shall apply to—

(i) any distributions with respect to, or disposition of, such stock in the first taxable year of the taxpayer for which such election is made, and

(ii) any amount which, but for section 1291, would have been included in gross income under subsection (a) with respect to such stock for such taxable year in the same manner as if such amount were gain on the disposition of such stock.

(B) Requirements.—The requirements of this subparagraph are met if, with respect to each of such corporation's taxable years for which such corporation was a passive foreign investment company and which begin after December 31, 1986, and included any portion of the taxpayer's holding period in such stock, such corporation was treated as a qualified electing fund under this part with respect to the taxpayer.

(2) Special rules for regulated investment companies.—

(A) In general.—If a regulated investment company elects the application of this section with respect to any marketable stock in a corporation after the beginning of the taxpayer's holding period in such stock, then, with respect to such company's first taxable year for which such company elects the application of this section with respect to such stock—

(i) section 1291 shall not apply to such stock with respect to any distribution or disposition during, or amount included in gross income under this section for, such first taxable year, but

(ii) such regulated investment company's tax under this chapter for such first taxable year shall be increased by the aggregate amount of interest which would have been determined under section 1291(c)(3) if section 1291 were applied without regard to this subparagraph.

Clause (ii) shall not apply if for the preceding taxable year the company elected to mark to market the stock held by such company as of the last day of such preceding taxable year.

(B) Disallowance of deduction.—No deduction shall be allowed to any regulated investment company for the increase in tax under subparagraph (A)(ii).

(k) Election.—This section shall apply to marketable stock in a passive foreign investment company which is held by a United States person only if such person elects to apply this section with respect to such stock. Such an election shall apply to the taxable year for which made and all subsequent taxable years unless—

(1) such stock ceases to be marketable stock, or

(2) the Secretary consents to the revocation of such election.

(l) Transition Rule for Individuals Becoming Subject To United States Tax.—If any individual becomes a United States person in a taxable year beginning after December 31, 1997, solely for purposes of this section, the adjusted basis (before adjustments under subsection (b)) of any marketable stock in a passive foreign investment company owned by such individual on the first day of such taxable year shall be treated as being the greater of its fair market value on such first day or its adjusted basis on such first day.

[CCH Explanation at ¶ 946. Committee Reports at ¶ 11,690.]

Amendment Notes

Act Sec. 1122(a) amended part VI of subchapter P of chapter 1 by redesignating subpart C as subpart D, by redesignating Code Secs. 1296 and 1297 as Code Secs. 1297 and 1298, respectively, and by inserting after subpart B a new subpart C (Code Sec. 1296) to read as above.

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and to tax years of foreign corporations ending with or within such tax years of United States persons.

[¶ 5369] CODE SEC. *1297*. PASSIVE FOREIGN INVESTMENT COMPANY.

* * *

(a) In General.—For purposes of this part, except as otherwise provided in this subpart, the term "passive foreign investment company" means any foreign corporation if—

* * *

(2) the average percentage of assets *(as determined in accordance with subsection (e))* held by such corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent.

* * *

Amendment Notes

Act Sec. 1122(a) redesignated Code Sec. 1296 as Code Sec. 1297.

Act Sec. 1123(b)(1)-(2) amended Code Sec. 1297(a), as redesignated by Act Sec. 1122(a), by striking "(by value)" and inserting "(as determined in accordance with subsection (e))", and by striking the last two sentences. Prior to amendment, the last two sentences of Code Sec. 1297(a) read as follows:

In the case of a controlled foreign corporation (or any other foreign corporation if such corporation so elects), the determination under paragraph (2) shall be based on the adjusted bases (as determined for purposes of computing earnings and profits) of its assets in lieu of their value. Such an election, once made, may be revoked only with the consent of the Secretary.

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and to tax years of foreign corporations ending with or within such tax years of United States persons.

(b) Passive Income.—For purposes of this section—

* * *

(3) *[Repealed.]*

* * *

Amendment Notes

Act Sec. 1122(d)(4) repealed Code Sec. 1297(b)(3). Prior to repeal, Code Sec. 1297(b)(3) read as follows:

(3) TREATMENT OF CERTAIN DEALERS IN SECURITIES.—

(A) IN GENERAL.—In the case of any foreign corporation which is a controlled foreign corporation (as defined in section 957(a)), the term "passive income" does not include any income derived in the active conduct of a securities business by such corporation if such corporation is registered as a securities broker or dealer under section 15(a) of the Securities Exchange Act of 1934 or is registered as a Government securities broker or dealer under section 15C(a) of such Act. To the extent provided in regulations, such term shall not include any income derived in the active conduct of a securities business by a controlled foreign corporation which is not so registered.

(B) APPLICATION OF LOOK-THRU RULES.—For purposes of paragraph (2)(C), rules similar to the rules of subparagraph (A) of this paragraph shall apply in determining whether any income of a related person (whether or not a corporation) is passive income.

(C) LIMITATION.—The preceding provisions of this paragraph shall only apply in the case of persons who are United States shareholders (as defined in section 951(b)) in the controlled foreign corporation.

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and to tax years of foreign corporations ending with or within such tax years of United States persons.

(e) EXCEPTION FOR UNITED STATES SHAREHOLDERS OF CONTROLLED FOREIGN CORPORATIONS.—

(1) IN GENERAL.—For purposes of this part, a corporation shall not be treated with respect to a shareholder as a passive foreign investment company during the qualified portion of such shareholder's holding period with respect to stock in such corporation.

(2) QUALIFIED PORTION.—For purposes of this subsection, the term "qualified portion" means the portion of the shareholder's holding period—

(A) which is after December 31, 1997, and

(B) during which the shareholder is a United States shareholder (as defined in section 951(b)) of the corporation and the corporation is a controlled foreign corporation.

(3) NEW HOLDING PERIOD IF QUALIFIED PORTION ENDS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), if the qualified portion of a shareholder's holding period with respect to any stock ends after December 31, 1997, solely for purposes of this part, the shareholder's holding period with respect to such stock shall be treated as beginning as of the first day following such period.

(B) EXCEPTION.—Subparagraph (A) shall not apply if such stock was, with respect to such shareholder, stock in a passive foreign investment company at any time before the qualified portion of the shareholder's holding period with respect to such stock and no election under section 1298(b)(1) is made.

Amendment Notes

Act Sec. 1121 amended Code Sec. 1296, prior to redesignation by Act Sec. 1122(a), by adding at the end a new subsection (e) to read as above.

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and to tax years of foreign corporations ending with or within such tax years of United States persons.

(e)[(f)] METHODS FOR MEASURING ASSETS.—

(1) DETERMINATION USING VALUE.—The determination under subsection (a)(2) shall be made on the basis of the value of the assets of a foreign corporation if—

(A) such corporation is a publicly traded corporation for the taxable year, or

(B) paragraph (2) does not apply to such corporation for the taxable year.

(2) DETERMINATION USING ADJUSTED BASES.—The determination under subsection (a)(2) shall be based on the adjusted bases (as determined for the purposes of computing earnings and profits) of the assets of a foreign corporation if such corporation is not described in paragraph (1)(A) and such corporation—

(A) is a controlled foreign corporation, or

(B) elects the application of this paragraph.

An election under subparagraph (B), once made, may be revoked only with the consent of the Secretary.

(3) PUBLICLY TRADED CORPORATION.—For purposes of this subsection, a foreign corporation shall be treated as a publicly traded corporation if the stock in the corporation is regularly traded on—

(A) a national securities exchange which is registered with the Securities and Exchange Commission or the national market system established pursuant to section 11A of the Securities and Exchange Act of 1934, or

(B) any exchange or other market which the Secretary determines has rules adequate to carry out the purposes of this subsection.

[CCH Explanation at ¶ 944, 946 and 948. Committee Reports at ¶ 11,685, 11,690 and 11,695.]

Amendment Notes

Act Sec. 1123(a) amended Code Sec. 1297, as redesignated by Act Sec. 1122(a), by adding at the end a new subsection (e)[(f)] to read as above.

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and to tax years of foreign corporations ending with or within such tax years of United States persons.

[¶ 5371] CODE SEC. *1298*. SPECIAL RULES.

* * *

(b) OTHER SPECIAL RULES.—For purposes of this part—

(1) TIME FOR DETERMINATION.—Stock held by a taxpayer shall be treated as stock in a passive foreign investment company if, at any time during the holding period of the taxpayer with respect to such stock, such corporation (or any predecessor) was a passive foreign investment company which was not a qualified electing fund. The preceding sentence shall not apply if the taxpayer elects to recognize gain (as of the last day of the last taxable year for which the company was a passive foreign investment company *(determined without regard to the preceding sentence)*) under rules similar to the rules of section 1291(d)(2).

* * *

[CCH Explanation at ¶ 946 and 948. Committee Reports at ¶ 11,690.]

Amendment Notes

Act Sec. 1122(a) redesignated Code Sec. 1297 as Code Sec. 1298.

Act Sec. 1122(e) amended Code Sec. 1298(b)(1), as redesignated by Act Sec. 1122(a), by inserting "(determined without regard to the preceding sentence)" after "investment company" in the last sentence.

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and tax years of foreign corporations ending with or within such tax years of United States persons.

[¶ 5373] *CODE SEC. 1301. AVERAGING OF FARM INCOME.*

(a) IN GENERAL.—At the election of an individual engaged in a farming business, the tax imposed by section 1 for such taxable year shall be equal to the sum of—

(1) a tax computed under such section on taxable income reduced by elected farm income, plus

(2) the increase in tax imposed by section 1 which would result if taxable income for each of the 3 prior taxable years were increased by an amount equal to one-third of the elected farm income.

Any adjustment under this section for any taxable year shall be taken into account in applying this section for any subsequent taxable year.

(b) DEFINITIONS.—In this section—

(1) ELECTED FARM INCOME.—

(A) IN GENERAL.—The term "elected farm income" means so much of the taxable income for the taxable year—

(i) which is attributable to any farming business; and

(ii) which is specified in the election under subsection (a).

(B) TREATMENT OF GAINS.—For purposes of subparagraph (A), gain from the sale or other disposition of property (other than land) regularly used by the taxpayer in such a farming business for a substantial period shall be treated as attributable to such a farming business.

(2) INDIVIDUAL.—The term "individual" shall not include any estate or trust.

(3) FARMING BUSINESS.—The term "farming business" has the meaning given such term by section 263A(e)(4).

(c) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations regarding—

(1) the order and manner in which items of income, gain, deduction, or loss, or limitations on tax, shall be taken into account in computing the tax imposed by this chapter on the income of any taxpayer to whom this section applies for any taxable year, and

(2) the treatment of any short taxable year.

[CCH Explanation at ¶ 361. Committee Reports at ¶ 10,665.]

Amendment Notes

Act Sec. 933(a) amended subchapter Q of chapter 1 by adding a new part I (Code Sec. 1301) to read as above.

The above amendment applies to tax years beginning after December 31, 1997, and before January 1, 2001.

[¶ 5375] CODE SEC. 1361. S CORPORATION DEFINED.

* * *

(b) SMALL BUSINESS CORPORATION.—

(1) IN GENERAL.—For purposes of this subchapter, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not—

(A) have more than 75 shareholders,

(B) have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in *subsection (c)(6)*) who is not an individual,

(C) have a nonresident alien as a shareholder, and

(D) have more than 1 class of stock.

* * *

(3) TREATMENT OF CERTAIN WHOLLY OWNED SUBSIDIARIES.—

(A) IN GENERAL.—*Except as provided in regulations prescribed by the Secretary, for purposes of this title*—

(i) a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and

(ii) all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

* * *

Amendment Notes

Act Sec. 1601(c)(3) amended Code Sec. 1361(b)(3)(A) by striking "For purposes of this title" and inserting "Except as provided in regulations prescribed by the Secretary, for purposes of this title".

Act Sec. 1601(c)(4)(C) amended Code Sec. 1361(b)(1)(B) by striking "subsection (c)(7)" and inserting "subsection (c)(6)".

The above amendments are effective as if included in the provisions of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which they relate [effective for tax years beginning after December 31, 1996.—CCH.].

(c) SPECIAL RULES FOR APPLYING SUBSECTION (b).—

* * *

(6) CERTAIN EXEMPT ORGANIZATIONS PERMITTED AS SHAREHOLDERS.—For purposes of subsection (b)(1)(B), an organization which is—

(A) described in section 401(a) or 501(c)(3), and

(B) exempt from taxation under section 501(a),

may be a shareholder in an S corporation.

* * *

Amendment Notes

Act Sec. 1601(c)(4)(B) amended Code Sec. 1361(c) by redesignating paragraph (7) as paragraph (6).

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years beginning after December 31, 1997.—CCH.].

(e) ELECTING SMALL BUSINESS TRUST DEFINED.—

(1) ELECTING SMALL BUSINESS TRUST.—For purposes of this section—

* * *

(B) CERTAIN TRUSTS NOT ELIGIBLE.—The term "electing small business trust" shall not include—

(i) any qualified subchapter S trust (as defined in subsection (d)(3)) if an election under subsection (d)(2) applies to any corporation the stock of which is held by such trust,

(ii) any trust exempt from tax under this subtitle, *and*

(iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in section 664(d)).

* * *

[CCH Explanation at ¶ 473 and 477. Committee Reports at ¶ 13,525 and 13,535.]

Amendment Notes

Act Sec. 1601(c)(1) amended Code Sec. 1361(e)(1)(B) by striking "and" at the end of clause (i), striking the period at the end of clause (ii) and inserting ", and", and adding at the end a new clause (iii) to read as above.

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

[¶ 5377] CODE SEC. 1374. TAX IMPOSED ON CERTAIN BUILT-IN GAINS.

* * *

(d) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

* * *

(7) RECOGNITION PERIOD.—The term "recognition period" means the 10-year period beginning with the 1st day of the 1st taxable year for which the corporation was an S corporation. *For purposes of applying this section to any amount includible in income by reason of section 593(e), the preceding sentence shall be applied without regard to the phrase "10-year".*

* * *

[CCH Explanation at ¶ 573. Committee Reports at ¶ 13,665.]

Amendment Notes

Act Sec. 1601(f)(5)(B) amended Code Sec. 1374(d)(7) by adding at the end a new sentence to read as above.

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years beginning after December 31, 1995.—CCH.].

[¶ 5379] CODE SEC. 1391. DESIGNATION PROCEDURE.

* * *

(b) NUMBER OF DESIGNATIONS.—

* * *

(2) EMPOWERMENT ZONES.—The appropriate Secretaries may designate in the aggregate *11* nominated areas as empowerment zones under this section, subject to the availability of eligible nominated areas. Of that number, not more than *8* may be designated in urban areas and not more than 3 may be designated in rural areas. If *8* empowerment zones are designated in urban areas, no less than 1 shall be designated in an urban area the most populous city of which has a population of 500,000 or less and no less than 1 shall be a nominated area which includes areas in 2 States and which has a population of 50,000 or less. The Secretary of Housing and Urban Development shall designate empowerment zones located in urban areas in such a manner that the aggregate population of all such zones does not exceed *1,000,000.*

Amendment Notes

Act Sec. 951(a)(1)-(3) amended Code Sec. 1391(b)(2) by striking "9" and inserting "11", by striking "6" and inserting "8", and by striking "750,000" and inserting "1,000,000".

The above amendment is effective on the date of the enactment of this Act, except that designations of new empowerment zones made pursuant to such amendment will be made during the 180-day period beginning on the date of the enactment of this Act. No designation pursuant to such amendment will take effect before January 1, 2000.

(c) PERIOD DESIGNATIONS MAY BE MADE.—A designation may be made under *subsection (a)* only after 1993 and before 1996.

* * *

Amendment Notes

Act Sec. 952(d)(2) amended Code Sec. 1391(c) by striking "this section" and inserting "subsection (a)".

The above amendment is effective on the date of enactment of this Act.

(e) LIMITATIONS ON DESIGNATIONS.—No area may be designated under *this section* unless—

(1) the area is nominated by 1 or more local governments and the State or States in which it is located for designation under this section,

(2) such State or States and the local governments have the authority—

(A) to nominate the area for designation under this section, and

(B) to provide the assurances described in paragraph (3),

(3) such State or States and the local governments provide written assurances satisfactory to the appropriate Secretary that the strategic plan described in the application under subsection (f)(2) for such area will be implemented,

(4) the appropriate Secretary determines that any information furnished is reasonably accurate, and

(5) such State or States and local governments certify that no portion of the area nominated is already included in an empowerment zone or in an enterprise community or in an area otherwise nominated to be designated under this section.

Amendment Notes

Act Sec. 952(d)(1) amended Code Sec. 1391(e) by striking "subsection (a)" and inserting "this section".

The above amendment is effective on the date of enactment of this Act.

(f) APPLICATION.—No area may be designated under *this section* unless the application for such designation—

(1) demonstrates that the nominated area satisfies the eligibility criteria described in section 1392,

(2) includes a strategic plan for accomplishing the purposes of this subchapter that—

(A) describes the coordinated economic, human, community, and physical development plan and related activities proposed for the nominated area,

(B) describes the process by which the affected community is a full partner in the process of developing and implementing the plan and the extent to which local institutions and organizations have contributed to the planning process,

(C) identifies the amount of State, local, and private resources that will be available in the nominated area and the private/public partnerships to be used, which may include participation by, and cooperation with, universities, medical centers, and other private and public entities,

(D) identifies the funding requested under any Federal program in support of the proposed economic, human, community, and physical development and related activities,

(E) identifies baselines, methods, and benchmarks for measuring the success of carrying out the strategic plan, including the extent to which poor persons and families will be empowered to become economically self-sufficient, and

(F) does not include any action to assist any establishment in relocating from one area outside the nominated area to the nominated area, except that assistance for the expansion of an existing business entity through the establishment of a new branch, affiliate, or subsidiary is permitted if—

(i) the establishment of the new branch, affiliate, or subsidiary will not result in a decrease in employment in the area of original location or in any other area where the existing business entity conducts business operations, and

(ii) there is no reason to believe that the new branch, affiliate, or subsidiary is being established with the intention of closing down the operations of the existing business entity in the area of its original location or in any other area where the existing business entity conducts business operation, and

(3) includes such other information as may be required by the appropriate Secretary.

Amendment Notes

Act Sec. 952(d)(1) amended Code Sec. 1391(f) by striking "subsection (a)" and inserting "this section".

The above amendment is effective on the date of enactment of this Act.

(g) ADDITIONAL DESIGNATIONS PERMITTED.—

(1) IN GENERAL.—In addition to the areas designated under subsection (a), the appropriate Secretaries may designate in the aggregate an additional 20 nominated areas as empowerment zones under this section, subject to the availability of eligible nominated areas. Of that number, not more than 15 may be designated in urban areas and not more than 5 may be designated in rural areas.

(2) PERIOD DESIGNATIONS MAY BE MADE AND TAKE EFFECT.—A designation may be made under this subsection after the date of the enactment of this subsection and before January 1, 1999.

(3) MODIFICATIONS TO ELIGIBILITY CRITERIA, ETC.—

(A) POVERTY RATE REQUIREMENT.—

(i) IN GENERAL.—A nominated area shall be eligible for designation under this subsection only if the poverty rate for each population census tract within the nominated area is not less than 20 percent and the poverty rate for at least 90 percent of the population census tracts within the nominated area is not less than 25 percent.

(ii) TREATMENT OF CENSUS TRACTS WITH SMALL POPULATIONS.—A population census tract with a population of less than 2,000 shall be treated as having a poverty rate of not less than 25 percent if—

(I) more than 75 percent of such tract is zoned for commercial or industrial use, and

(II) such tract is contiguous to 1 or more other population census tracts which have a poverty rate of not less than 25 percent (determined without regard to this clause).

(iii) EXCEPTION FOR DEVELOPABLE SITES.—Clause (i) shall not apply to up to 3 noncontiguous parcels in a nominated area which may be developed for commercial or industrial purposes. The aggregate area of noncontiguous parcels to which the preceding sentence applies with respect to any nominated area shall not exceed 2,000 acres.

(iv) CERTAIN PROVISIONS NOT TO APPLY.—Section 1392(a)(4) (and so much of paragraphs (1) and (2) of section 1392(b) as relate to section 1392(a)(4)) shall not apply to an area nominated for designation under this subsection.

(v) SPECIAL RULE FOR RURAL EMPOWERMENT ZONE.—The Secretary of Agriculture may designate not more than 1 empowerment zone in a rural area without regard to clause (i) if such area satisfies emigration criteria specified by the Secretary of Agriculture.

(B) SIZE LIMITATION.—

(i) IN GENERAL.—The parcels described in subparagraph (A)(iii) shall not be taken into account in determining whether the requirement of subparagraph (A) or (B) of section 1392(a)(3) is met.

(ii) SPECIAL RULE FOR RURAL AREAS.—If a population census tract (or equivalent division under section 1392(b)(4)) in a rural area exceeds 1,000 square miles or includes a substantial amount of land owned by the Federal, State, or local government, the nominated area may exclude such excess square mileage or governmentally owned land and the exclusion of that area will not be treated as violating the continuous boundary requirement of section 1392(a)(3)(B).

(C) AGGREGATE POPULATION LIMITATION.—The aggregate population limitation under the last sentence of subsection (b)(2) shall not apply to a designation under paragraph (1)(B).

(D) PREVIOUSLY DESIGNATED ENTERPRISE COMMUNITIES MAY BE INCLUDED.—Subsection (e)(5) shall not apply to any enterprise community designated under subsection (a) that is also nominated for designation under this subsection.

(E) INDIAN RESERVATIONS MAY BE NOMINATED.—

(i) IN GENERAL.—Section 1393(a)(4) shall not apply to an area nominated for designation under this subsection.

(ii) SPECIAL RULE.—An area in an Indian reservation shall be treated as nominated by a State and a local government if it is nominated by the reservation governing body (as determined by the Secretary of Interior).

[CCH Explanation at ¶ 371, 372 and 373. Committee Reports at ¶ 10,735.]

Amendment Notes

Act Sec. 952(a) amended Code Sec. 1391 by adding a new subsection (g) to read as above.

The above amendment is effective on the date of enactment of this Act.

[¶ 5381] CODE SEC. 1392. ELIGIBILITY CRITERIA.

* * *

(d) SPECIAL ELIGIBILITY FOR NOMINATED AREAS LOCATED IN ALASKA OR HAWAII.—A nominated area in Alaska or Hawaii shall be treated as meeting the requirements of paragraphs (2), (3), and (4) of subsection (a) if for each census tract or block group within such area 20 percent or more of the families have income which is 50 percent or less of the statewide median family income (as determined under section 143).

* * *

[CCH Explanation at ¶ 375. Committee Reports at ¶ 10,735.]

Amendment Notes

Act Sec. 954 amended Code Sec. 1392 by adding at the end a new subsection (d) to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5383] CODE SEC. 1394. TAX-EXEMPT ENTERPRISE ZONE FACILITY BONDS.

* * *

(b) ENTERPRISE ZONE FACILITY.—For purposes of this section—

* * *

(2) QUALIFIED ZONE PROPERTY.—The term "qualified zone property" has the meaning given such term by section 1397C; except that—

(A) the references to empowerment zones shall be treated as including references to enterprise communities, and

(B) section 1397C(a)(2) shall be applied by substituting "an amount equal to 15 percent of the adjusted basis" for "an amount equal to the adjusted basis".

(3) ENTERPRISE ZONE BUSINESS.—

(A) IN GENERAL.—Except as modified in this paragraph, the term "enterprise zone business" has the meaning given such term by section 1397B.

(B) MODIFICATIONS.—In applying section 1397B for purposes of this section—

(i) BUSINESSES IN ENTERPRISE COMMUNITIES ELIGIBLE.—References in section 1397B to empowerment zones shall be treated as including references to enterprise communities.

(ii) WAIVER OF REQUIREMENTS DURING STARTUP PERIOD.—A business shall not fail to be treated as an enterprise zone business during the startup period if—

(I) as of the beginning of the startup period, it is reasonably expected that such business will be an enterprise zone business (as defined in section 1397B as modified by this paragraph) at the end of such period, and

(II) such business makes bona fide efforts to be such a business.

(iii) REDUCED REQUIREMENTS AFTER TESTING PERIOD.—A business shall not fail to be treated as an enterprise zone business for any taxable year beginning after the testing period by reason of failing to meet any requirement of subsection (b) or (c) of section 1397B if at least 35 percent of the employees of such business for such year are residents of an empowerment zone or an enterprise community. The preceding sentence shall not apply to any business which is not a qualified business by reason of paragraph (1), (4), or (5) of section 1397B(d).

(C) DEFINITIONS RELATING TO SUBPARAGRAPH (B).—For purposes of subparagraph (B)—

(i) STARTUP PERIOD.—The term "startup period" means, with respect to any property being provided for any business, the period before the first taxable year beginning more than 2 years after the later of—

(I) the date of issuance of the issue providing such property, or

(II) the date such property is first placed in service after such issuance (or, if earlier, the date which is 3 years after the date described in subclause (I)).

(ii) TESTING PERIOD.—The term "testing period" means the first 3 taxable years beginning after the startup period.

(D) PORTIONS OF BUSINESS MAY BE ENTERPRISE ZONE BUSINESS.—The term "enterprise zone business" includes any trades or businesses which would qualify as an enterprise zone business (determined after the modifications of subparagraph (B)) if such trades or businesses were separately incorporated.

* * *

Amendment Notes

Act Sec. 955(a) amended Code Sec. 1394(b)(3) to read as above. Prior to amendment, Code Sec. 1394(b)(3) read as follows:

(3) ENTERPRISE ZONE BUSINESS.—The term "enterprise zone business" has the meaning given to such term by section 1397B, except that—

(A) references to empowerment zones shall be treated as including references to enterprise communities, and

(B) such term includes any trades or businesses which would qualify as an enterprise zone business (determined after the modification of subparagraph (A)) if such trades or businesses were separately incorporated.

Act Sec. 955(b) amended Code Sec. 1394(b)(2) to read as above. Prior to amendment, Code Sec. 1394(b)(2) read as follows:

(2) QUALIFIED ZONE PROPERTY.—The term "qualified zone property" has the meaning given such term by section 1397C; except that the references to empowerment zones shall be treated as including references to enterprise communities.

The above amendments apply to obligations issued after the date of the enactment of this Act.

(f) BONDS FOR EMPOWERMENT ZONES DESIGNATED UNDER SECTION 1391(g).—

(1) IN GENERAL.—In the case of a new empowerment zone facility bond—

(A) such bond shall not be treated as a private activity bond for purposes of section 146, and

(B) subsection (c) of this section shall not apply.

(2) LIMITATION ON AMOUNT OF BONDS.—

(A) IN GENERAL.—Paragraph (1) shall apply to a new empowerment zone facility bond only if such bond is designated for purposes of this subsection by the local government which nominated the area to which such bond relates.

(B) LIMITATION ON BONDS DESIGNATED.—The aggregate face amount of bonds which may be designated under subparagraph (A) with respect to any empowerment zone shall not exceed—

(i) $60,000,000 if such zone is in a rural area,

(ii) $130,000,000 if such zone is in an urban area and the zone has a population of less than 100,000, and

(iii) $230,000,000 if such zone is in an urban area and the zone has a population of at least 100,000.

(C) SPECIAL RULES.—

(i) COORDINATION WITH LIMITATION IN SUBSECTION (C).—Bonds to which paragraph (1) applies shall not be taken into account in applying the limitation of subsection (c) to other bonds.

(ii) CURRENT REFUNDING NOT TAKEN INTO ACCOUNT.—In the case of a refunding (or series of refundings) of a bond designated under this paragraph, the refunding obligation shall be treated as designated under this paragraph (and shall not be taken into account in applying subparagraph (B)) if—

(I) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, and

(II) the refunded bond is redeemed not later than 90 days after the date of issuance of the refunding bond.

(3) NEW EMPOWERMENT ZONE FACILITY BOND.—For purposes of this subsection, the term "new empowerment zone facility bond" means any bond which would be described in subsection (a) if only empowerment zones designated under section 1391(g) were taken into account under sections 1397B and 1397C.

* * *

[CCH Explanation at ¶ 377, 378 and 379. Committee Reports at ¶ 10,735.]

Amendment Notes

Act Sec. 953(a) amended Code Sec. 1394 by adding a new subsection (f) to read as above.

The above amendment applies to obligations issued after the date of the enactment of this Act.

[¶ 5385] CODE SEC. 1396. EMPOWERMENT ZONE EMPLOYMENT CREDIT.

* * *

(b) APPLICABLE PERCENTAGE.—For purposes of this section—

(1) IN GENERAL.—Except as provided in paragraph (2), the term "applicable percentage" means the percentage determined in accordance with the following table:

In the case of wages paid or incurred during calendar year:	*The applicable percentage is:*
1994 through 2001	*20*
2002	*15*
2003	*10*
2004	*5*

(2) SPECIAL RULE.—With respect to each empowerment zone designated pursuant to the amendments made by the Taxpayer Relief Act of 1997 to section 1391(b)(2), the following table shall apply in lieu of the table in paragraph (1):

In the case of wages paid or incurred during calendar year—	*The applicable percentage is—*
2000 through 2004	*20*
2005	*15*
2006	*10*
2007	*5*

* * *

Amendment Notes

Act Sec. 951(b)(1)-(2) amended Code Sec. 1396(b) by striking so much of the subsection as precedes the table and inserting new material to read as above, and by adding at the end a new paragraph (2) to read as above. Prior to amendment, the material in subsection (b) preceding the table read as follows:

(b) APPLICABLE PERCENTAGE.—For purposes of this section, the term "applicable percentage" means the percentage determined in accordance with the following table:

The above amendment is effective on the date of the enactment of this Act, except that designations of new empowerment zones made pursuant to such amendment will be made during the 180-day period beginning on the date of the enactment of this Act. No designation pursuant to such amendment will take effect before January 1, 2000.

(e) CREDIT NOT TO APPLY TO EMPOWERMENT ZONES DESIGNATED UNDER SECTION 1391(g).—This section shall be applied without regard to any empowerment zone designated under section 1391(g).

[CCH Explanation at ¶ 371 and 372. Committee Reports at ¶ 10,735.]

Amendment Notes

Act Sec. 952(b) amended Code Sec. 1396 by adding at the and a new subsection (e) to read as above.

The above amendment is effective on the date of enactment of this Act.

[¶ 5387] CODE SEC. 1397A. INCREASE IN EXPENSING UNDER SECTION 179.

* * *

(c) LIMITATION.—For purposes of this section, qualified zone property shall not include any property substantially all of the use of which is in any parcel described in section 1391(g)(3)(A)(iii).

[CCH Explanation at ¶ 372. Committee Reports at ¶ 10,735.]

Amendment Notes

Act Sec. 952(c) amended Code Sec. 1397A by adding at the end a new subsection (c) to read as above.

The above amendment is effective on the date of enactment of this Act.

[¶ 5389] CODE SEC. 1397B. ENTERPRISE ZONE BUSINESS DEFINED.

* * *

(b) QUALIFIED BUSINESS ENTITY.—For purposes of this section, the term "qualified business entity" means, with respect to any taxable year, any corporation or partnership if for such year—

(1) every trade or business of such entity is the active conduct of a qualified business within an empowerment zone,

(2) at least *50 percent* of the total gross income of such entity is derived from the active conduct of such business,

(3) *a substantial portion* of the use of the tangible property of such entity (whether owned or leased) is within an empowerment zone,

(4) *a substantial portion* of the intangible property of such entity is used in the active conduct of any such business,

(5) *a substantial portion* of the services performed for such entity by its employees are performed in an empowerment zone,

(6) at least 35 percent of its employees are residents of an empowerment zone,

(7) less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to collectibles (as defined in section 408(m)(2)) other than collectibles that are held primarily for sale to customers in the ordinary course of such business, and

(8) less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property.

Amendment Notes

Act Sec. 956(a)(1)-(3) amended Code Sec. 1397B(b) by striking "80 percent" in paragraph (2) and inserting "50 percent", by striking "substantially all" each place it appears and inserting "a substantial portion", and by striking ", and exclusively related to," after "is used in," in paragraph (4).

The above amendment generally applies to tax years beginning on or after the date of the enactment of this Act. For a special rule, see Act Sec. 956(b)(2), below.

Act Sec. 956(b)(2) provides:

(2) SPECIAL RULE FOR ENTERPRISE ZONE FACILITY BONDS.—For purposes of section 1394(b) of the Internal Revenue Code of 1986, the amendments made by this section shall apply to obligations issued after the date of the enactment of this Act.

(c) QUALIFIED PROPRIETORSHIP.—For purposes of this section, the term "qualified proprietorship" means, with respect to any taxable year, any qualified business carried on by an individual as a proprietorship if for such year—

(1) at least *50 percent* of the total gross income of such individual from such business is derived from the active conduct of such business in an empowerment zone,

(2) *a substantial portion* of the use of the tangible property of such individual in such business (whether owned or leased) is within an empowerment zone,

(3) *a substantial portion* of the intangible property of such business is used in the active conduct of such business,

(4) *a substantial portion* of the services performed for such individual in such business by employees of such business are performed in an empowerment zone,

(5) at least 35 percent of such employees are residents of an empowerment zone,

(6) less than 5 percent of the average of the aggregate unadjusted bases of the property of such individual which is used in such business is attributable to collectibles (as defined in section 408(m)(2)) other than collectibles that are held primarily for sale to customers in the ordinary course of such business, and

(7) less than 5 percent of the average of the aggregate unadjusted bases of the property of such individual which is used in such business is attributable to nonqualified financial property.

For purposes of this subsection, the term "employee" includes the proprietor.

Amendment Notes

Act Sec. 956(a)(1)-(3) amended Code Sec. 1397B(c) by striking "80 percent" in paragraph (1) and inserting "50 percent", by striking "substantially all" each place it appears and inserting "a substantial portion", and by striking ", and exclusively related to," after "is used in," in paragraph (3).

The above amendment generally applies to tax years beginning on or after the date of the enactment of this Act. For a special rule, see Act Sec. 956(b)(2), below.

Act Sec. 956(b)(2) provides:

(2) SPECIAL RULE FOR ENTERPRISE ZONE FACILITY BONDS.—For purposes of section 1394(b) of the Internal Revenue Code of 1986, the amendments made by this section shall apply to obligations issued after the date of the enactment of this Act.

(d) QUALIFIED BUSINESS.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the term "qualified business" means any trade or business.

(2) RENTAL OF REAL PROPERTY.—The rental to others of real property located in an empowerment zone shall be treated as a qualified business if and only if—

(A) the property is not residential rental property (as defined in section 168(e)(2)), and

(B) at least 50 percent of the gross rental income from the real property is from enterprise zone businesses.

For purposes of subparagraph (B), the lessor of the property may rely on a lessee's certification that such lessee is an enterprise zone business.

(3) RENTAL OF TANGIBLE PERSONAL PROPERTY.—The rental to others of tangible personal property shall be treated as a qualified business if and only if *at least 50 percent* of the rental of such property is by enterprise zone businesses or by residents of an empowerment zone.

* * *

Amendment Notes

Act Sec. 956(a)(4)-(5) amended Code Sec. 1397B(d) by adding at the end of paragraph (2) a new flush sentence to read as above, and by striking "substantially all" in paragraph (3) and inserting "at least 50 percent".

The above amendment generally applies to tax years beginning on or after the date of the enactment of this Act. For a special rule, see Act Sec. 956(b)(2), below.

Act Sec. 956(b)(2) provides:

(2) SPECIAL RULE FOR ENTERPRISE ZONE FACILITY BONDS.—For purposes of section 1394(b) of the Internal Revenue Code of 1986, the amendments made by this section shall apply to obligations issued after the date of the enactment of this Act.

(f) TREATMENT OF BUSINESSES STRADDLING CENSUS TRACT LINES.—For purposes of this section, if—

(1) a business entity or proprietorship uses real property located within an empowerment zone,

(2) the business entity or proprietorship also uses real property located outside the empowerment zone,

(3) the amount of real property described in paragraph (1) is substantial compared to the amount of real property described in paragraph (2), and

(4) the real property described in paragraph (2) is contiguous to part or all of the real property described in paragraph (1), then all the services performed by employees, all business activities, all tangible property, and all intangible property of the business entity or proprietorship that occur in or is located on the real property described in paragraphs (1) and (2) shall be treated as occurring or situated in an empowerment zone.

* * *

[CCH Explanation at ¶ 374. Committee Reports at ¶ 10,735.]

Amendment Notes

Act Sec. 956(a)(6) amended Code Sec. 1397B by adding at the end a new subsection (f) to read as above.

The above amendment generally applies to tax years beginning on or after the date of the enactment of this Act. For a special rule, see Act Sec. 956(b)(2), below.

Act Sec. 956(b)(2) provides:

(2) SPECIAL RULE FOR ENTERPRISE ZONE FACILITY BONDS.—For purposes of section 1394(b) of the Internal Revenue Code of 1986, the amendments made by this section shall apply to obligations issued after the date of the enactment of this Act.

[¶ 5391] *CODE SEC. 1397E. CREDIT TO HOLDERS OF QUALIFIED ZONE ACADEMY BONDS.*

(a) ALLOWANCE OF CREDIT.—In the case of an eligible taxpayer who holds a qualified zone academy bond on the credit allowance date of such bond which occurs during the taxable year, there shall be allowed as a credit against the tax imposed by this chapter for such taxable year the amount determined under subsection (b).

(b) AMOUNT OF CREDIT.—

(1) IN GENERAL.—The amount of the credit determined under this subsection with respect to any qualified zone academy bond is the amount equal to the product of—

(A) the credit rate determined by the Secretary under paragraph (2) for the month in which such bond was issued, multiplied by

(B) the face amount of the bond held by the taxpayer on the credit allowance date.

(2) DETERMINATION.—During each calendar month, the Secretary shall determine a credit rate which shall apply to bonds issued during the following calendar month. The credit rate for any month is the percentage which the Secretary estimates will permit the issuance of qualified zone academy bonds without discount and without interest cost to the issuer.

(c) LIMITATION BASED ON AMOUNT OF TAX.—The credit allowed under subsection (a) for any taxable year shall not exceed the excess of—

(1) the sum of the regular tax liability (as defined in section 26(b)) plus the tax imposed by section 55, over

(2) the sum of the credits allowable under part IV of subchapter A (other than subpart C thereof, relating to refundable credits).

(d) QUALIFIED ZONE ACADEMY BOND.—For purposes of this section—

(1) IN GENERAL.—The term "qualified zone academy bond" means any bond issued as part of an issue if—

(A) 95 percent or more of the proceeds of such issue are to be used for a qualified purpose with respect to a qualified zone academy established by an eligible local education agency,

(B) the bond is issued by a State or local government within the jurisdiction of which such academy is located,

(C) the issuer—

(i) designates such bond for purposes of this section,

(ii) certifies that it has written assurances that the private business contribution requirement of paragraph (2) will be met with respect to such academy, and

(iii) certifies that it has the written approval of the eligible local education agency for such bond issuance, and

(D) the term of each bond which is part of such issue does not exceed the maximum term permitted under paragraph (3).

(2) PRIVATE BUSINESS CONTRIBUTION REQUIREMENT.—

(A) IN GENERAL.—For purposes of paragraph (1), the private business contribution requirement of this paragraph is met with respect to any issue if the eligible local education agency that established the qualified zone academy has written commitments from private

entities to make qualified contributions having a present value (as of the date of issuance of the issue) of not less than 10 percent of the proceeds of the issue.

(B) QUALIFIED CONTRIBUTIONS.—For purposes of subparagraph (A), the term "qualified contribution" means any contribution (of a type and quality acceptable to the eligible local education agency) of—

(i) equipment for use in the qualified zone academy (including state-of-the-art technology and vocational equipment),

(ii) technical assistance in developing curriculum or in training teachers in order to promote appropriate market driven technology in the classroom,

(iii) services of employees as volunteer mentors,

(iv) internships, field trips, or other educational opportunities outside the academy for students, or

(v) any other property or service specified by the eligible local education agency.

(3) TERM REQUIREMENT.—During each calendar month, the Secretary shall determine the maximum term permitted under this paragraph for bonds issued during the following calendar month. Such maximum term shall be the term which the Secretary estimates will result in the present value of the obligation to repay the principal on the bond being equal to 50 percent of the face amount of the bond. Such present value shall be determined using as a discount rate the average annual interest rate of tax-exempt obligations having a term of 10 years or more which are issued during the month. If the term as so determined is not a multiple of a whole year, such term shall be rounded to the next highest whole year.

(4) QUALIFIED ZONE ACADEMY.—

(A) IN GENERAL.—The term "qualified zone academy" means any public school (or academic program within a public school) which is established by and operated under the supervision of an eligible local education agency to provide education or training below the postsecondary level if—

(i) such public school or program (as the case may be) is designed in cooperation with business to enhance the academic curriculum, increase graduation and employment rates, and better prepare students for the rigors of college and the increasingly complex workforce,

(ii) students in such public school or program (as the case may be) will be subject to the same academic standards and assessments as other students educated by the eligible local education agency,

(iii) the comprehensive education plan of such public school or program is approved by the eligible local education agency, and

(iv)(I) such public school is located in an empowerment zone or enterprise community (including any such zone or community designated after the date of the enactment of this section), or

(II) there is a reasonable expectation (as of the date of issuance of the bonds) that at least 35 percent of the students attending such school or participating in such program (as the case may be) will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

(B) ELIGIBLE LOCAL EDUCATION AGENCY.—The term "eligible local education agency" means any local education agency as defined in section 14101 of the Elementary and Secondary Education Act of 1965.

(5) QUALIFIED PURPOSE.—The term "qualified purpose" means, with respect to any qualified zone academy—

(A) rehabilitating or repairing the public school facility in which the academy is established,

(B) providing equipment for use at such academy,

(C) developing course materials for education to be provided at such academy, and

(D) training teachers and other school personnel in such academy.

(6) ELIGIBLE TAXPAYER.—The term "eligible taxpayer" means—

(A) a bank (within the meaning of section 581),

(B) an insurance company to which subchapter L applies, and

(C) a corporation actively engaged in the business of lending money.

(e) LIMITATION ON AMOUNT OF BONDS DESIGNATED.—

(1) NATIONAL LIMITATION.—There is a national zone academy bond limitation for each calendar year. Such limitation is $400,000,000 for 1998 and 1999, and, except as provided in paragraph (4), zero thereafter.

(2) ALLOCATION OF LIMITATION.—The national zone academy bond limitation for a calendar year shall be allocated by the Secretary among the States on the basis of their respective populations of individuals below the poverty line (as defined by the Office of Management and Budget). The limitation amount allocated to a State under the preceding sentence shall be allocated by the State education agency to qualified zone academies within such State.

(3) DESIGNATION SUBJECT TO LIMITATION AMOUNT.—The maximum aggregate face amount of bonds issued during any calendar year which may be designated under subsection (d)(1) with respect to any qualified zone academy shall not exceed the limitation amount allocated to such academy under paragraph (2) for such calendar year.

(4) CARRYOVER OF UNUSED LIMITATION.—If for any calendar year—

(A) the limitation amount for any State, exceeds

(B) the amount of bonds issued during such year which are designated under subsection (d)(1) with respect to qualified zone academies within such State, the limitation amount for such State for the following calendar year shall be increased by the amount of such excess.

(f) OTHER DEFINITIONS.—For purposes of this section—

(1) CREDIT ALLOWANCE DATE.—The term "credit allowance date" means, with respect to any issue, the last day of the 1-year period beginning on the date of issuance of such issue and the last day of each successive 1-year period thereafter.

(2) BOND.—The term "bond" includes any obligation.

(3) STATE.—The term "State" includes the District of Columbia and any possession of the United States.

(g) CREDIT INCLUDED IN GROSS INCOME.—Gross income includes the amount of the credit allowed to the taxpayer under this section.

[CCH Explanation at ¶ 161. Committee Reports at ¶ 10,240.]

Amendment Notes

Act Sec. 226(a) amended subchapter U of chapter 1 by redesignating part IV as part V, by redesignating Code Sec. 1397E[D] as Code Sec. 1397F, and by inserting after part III a new part IV (Code Sec. 1397E) to read as above.

The above amendment applies to obligations issued after December 31, 1997.

[¶ 5393] CODE SEC. *1397F*. REGULATIONS.

* * *

[CCH Explanation at ¶ 161. Committee Reports at ¶ 10,240.]

Amendment Notes

Act Sec. 226(a) redesignated Code Sec. 1397E[D] as Code Sec. 1397F.

The above amendment applies to obligations issued after December 31, 1997.

[¶ 5395] *CODE SEC. 1400. ESTABLISHMENT OF DC ZONE.*

(a) IN GENERAL.—For purposes of this title—

(1) the applicable DC area is hereby designated as the District of Columbia Enterprise Zone, and

(2) except as otherwise provided in this subchapter, the District of Columbia Enterprise Zone shall be treated as an empowerment zone designated under subchapter U.

(b) APPLICABLE DC AREA.—For purposes of subsection (a), the term "applicable DC area" means the area consisting of—

(1) the census tracts located in the District of Columbia which are part of an enterprise community designated under subchapter U before the date of the enactment of this subchapter, and

(2) all other census tracts—

(A) which are located in the District of Columbia, and

(B) for which the poverty rate is not less than than 20 percent.

(c) DISTRICT OF COLUMBIA ENTERPRISE ZONE.—For purposes of this subchapter, the terms "District of Columbia Enterprise Zone" and "DC Zone" mean the District of Columbia Enterprise Zone designated by subsection (a).

(d) SPECIAL RULES FOR APPLICATION OF EMPLOYMENT CREDIT.—

(1) EMPLOYEES WHOSE PRINCIPAL PLACE OF ABODE IS IN DISTRICT OF COLUMBIA.—With respect to the DC Zone, section 1396(d)(1)(B) (relating to empowerment zone employment credit) shall be applied by substituting "the District of Columbia" for "such empowerment zone".

(2) NO DECREASE OF PERCENTAGE IN 2002.—In the case of the DC Zone, section 1396 (relating to empowerment zone employment credit) shall be applied by substituting "20" for "15" in the table contained in section 1396(b). The preceding sentence shall apply only with respect to qualified zone employees, as defined in section 1396(d), determined by treating no area other than the DC Zone as an empowerment zone or enterprise community.

(e) SPECIAL RULE FOR APPLICATION OF ENTERPRISE ZONE BUSINESS DEFINITION.—For purposes of this subchapter and for purposes of applying subchapter U with respect to the DC Zone, section 1397B shall be applied without regard to subsections (b)(6) and (c)(5) thereof.

(f) TIME FOR WHICH DESIGNATION APPLICABLE.—

(1) IN GENERAL.—The designation made by subsection (a) shall apply for the period beginning on January 1, 1998, and ending on December 31, 2002.

(2) COORDINATION WITH DC ENTERPRISE COMMUNITY DESIGNATED UNDER SUBCHAPTER U.—The designation under subchapter U of the census tracts referred to in subsection (b)(1) as an enterprise community shall terminate on December 31, 2002.

[CCH Explanation at ¶ 381, 383, 385 and 387. Committee Reports at ¶ 10,465.]

Amendment Notes

Act Sec. 701(a) amended chapter 1 by adding a new subchapter W (Code Sec. 1400-1400C) read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5397] *CODE SEC. 1400A. TAX-EXEMPT ECONOMIC DEVELOPMENT BONDS.*

(a) IN GENERAL.—In the case of the District of Columbia Enterprise Zone, subparagraph (A) of section 1394(c)(1) (relating to limitation on amount of bonds) shall be applied by substituting "$15,000,000" for "$3,000,000".

(b) PERIOD OF APPLICABILITY.—This section shall apply to bonds issued during the period beginning on January 1, 1998, and ending on December 31, 2002.

[CCH Explanation at ¶ 381, 383, 385 and 387. Committee Reports at ¶ 10,465.]

Amendment Notes

Act Sec. 701(a) added a new Code Sec. 1400A to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5399] *CODE SEC. 1400B. ZERO PERCENT CAPITAL GAINS RATE.*

(a) EXCLUSION.—Gross income shall not include qualified capital gain from the sale or exchange of any DC Zone asset held for more than 5 years.

(b) DC ZONE ASSET.—For purposes of this section—

(1) IN GENERAL.—The term "DC Zone asset" means—

(A) any DC Zone business stock,

(B) any DC Zone partnership interest, and

(C) any DC Zone business property.

(2) DC ZONE BUSINESS STOCK.—

(A) IN GENERAL.—The term "DC Zone business stock" means any stock in a domestic corporation which is originally issued after December 31, 1997, if—

(i) such stock is acquired by the taxpayer, before January 1, 2003, at its original issue (directly or through an underwriter) solely in exchange for cash,

(ii) as of the time such stock was issued, such corporation was a DC Zone business (or, in the case of a new corporation, such corporation was being organized for purposes of being a DC Zone business), and

(iii) during substantially all of the taxpayer's holding period for such stock, such corporation qualified as a DC Zone business.

(B) Redemptions.—A rule similar to the rule of section 1202(c)(3) shall apply for purposes of this paragraph.

(3) DC zone partnership interest.—The term "DC Zone partnership interest" means any capital or profits interest in a domestic partnership which is originally issued after December 31, 1997, if—

(A) such interest is acquired by the taxpayer, before January 1, 2003, from the partnership solely in exchange for cash,

(B) as of the time such interest was acquired, such partnership was a DC Zone business (or, in the case of a new partnership, such partnership was being organized for purposes of being a DC Zone business), and

(C) during substantially all of the taxpayer's holding period for such interest, such partnership qualified as a DC Zone business.

A rule similar to the rule of paragraph (2)(B) shall apply for purposes of this paragraph.

(4) DC zone business property.—

(A) In general.—The term "DC Zone business property" means tangible property if—

(i) such property was acquired by the taxpayer by purchase (as defined in section 179(d)(2)) after December 31, 1997, and before January 1, 2003,

(ii) the original use of such property in the DC Zone commences with the taxpayer, and

(iii) during substantially all of the taxpayer's holding period for such property, substantially all of the use of such property was in a DC Zone business of the taxpayer.

(B) Special rule for buildings which are substantially improved.—

(i) In general.—The requirements of clauses (i) and (ii) of subparagraph (A) shall be treated as met with respect to—

(I) property which is substantially improved by the taxpayer before January 1, 2003, and

(II) any land on which such property is located.

(ii) Substantial improvement.—For purposes of clause (i), property shall be treated as substantially improved by the taxpayer only if, during any 24-month period beginning after December 31, 1997, additions to basis with respect to such property in the hands of the taxpayer exceed the greater of—

(I) an amount equal to the adjusted basis of such property at the beginning of such 24-month period in the hands of the taxpayer, or

(II) $5,000.

(6) Treatment of subsequent purchasers, etc.—The term "DC Zone asset" includes any property which would be a DC Zone asset but for paragraph (2)(A)(i), (3)(A), or (4)(A)(ii) in the hands of the taxpayer if such property was a DC Zone asset in the hands of a prior holder.

(7) 5-year safe harbor.—If any property ceases to be a DC Zone asset by reason of paragraph (2)(A)(iii), (3)(C), or (4)(A)(iii) after the 5-year period beginning on the date the taxpayer acquired such property, such property shall continue to be treated as meeting the requirements of such paragraph; except that the amount of gain to which subsection (a) applies on any sale or exchange of such property shall not exceed the amount which would be qualified capital gain had such property been sold on the date of such cessation.

(c) DC Zone Business.—For purposes of this section, the term "DC Zone business" means any entity which is an enterprise zone business (as defined in section 1397B), determined—

(1) after the application of section 1400(e),

(2) by substituting "80 percent" for "50 percent" in subsections (b)(2) and (c)(1) of section 1397B, and

(3) by treating no area other than the DC Zone as an empowerment zone or enterprise community.

(d) Treatment of Zone as Including Census Tracts With 10 Percent Poverty Rate.—For purposes of applying this section (and for purposes of applying this subchapter and subchapter U with respect to this section), the DC Zone shall be treated as including all census tracts—

(1) which are located in the District of Columbia, and

(2) for which the poverty rate is not less than 10 percent.

(e) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) QUALIFIED CAPITAL GAIN.—Except as otherwise provided in this subsection, the term "qualified capital gain" means any gain recognized on the sale or exchange of—

(A) a capital asset, or

(B) property used in the trade or business (as defined in section 1231(b)).

(2) GAIN BEFORE 1998 OR AFTER 2007 NOT QUALIFIED.—The term "qualified capital gain" shall not include any gain attributable to periods before January 1, 1998, or after December 31, 2007.

(3) CERTAIN GAIN NOT QUALIFIED.—The term "qualified capital gain" shall not include any gain which would be treated as ordinary income under section 1245 or under section 1250 if section 1250 applied to all depreciation rather than the additional depreciation.

(4) INTANGIBLES AND LAND NOT INTEGRAL PART OF DC ZONE BUSINESS.—The term "qualified capital gain" shall not include any gain which is attributable to real property, or an intangible asset, which is not an integral part of a DC Zone business.

(5) RELATED PARTY TRANSACTIONS.—The term "qualified capital gain" shall not include any gain attributable, directly or indirectly, in whole or in part, to a transaction with a related person. For purposes of this paragraph, persons are related to each other if such persons are described in section 267(b) or 707(b)(1).

(f) CERTAIN OTHER RULES TO APPLY.—Rules similar to the rules of subsections (g), (h), (i)(2), and (j) of section 1202 shall apply for purposes of this section.

(g) SALES AND EXCHANGES OF INTERESTS IN PARTNERSHIPS AND S CORPORATIONS WHICH ARE DC ZONE BUSINESSES.—In the case of the sale or exchange of an interest in a partnership, or of stock in an S corporation, which was a DC Zone business during substantially all of the period the taxpayer held such interest or stock, the amount of qualified capital gain shall be determined without regard to—

(1) any gain which is attributable to real property, or an intangible asset, which is not an integral part of a DC Zone business, and

(2) any gain attributable to periods before January 1, 1998, or after December 31, 2007.

[CCH Explanation at ¶ 381, 383, 385 and 387. Committee Reports at ¶ 10,465.]

Amendment Notes

Act Sec. 701(a) added a new Code Sec. 1400B to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5401] *CODE SEC. 1400C. FIRST-TIME HOMEBUYER CREDIT FOR DISTRICT OF COLUMBIA.*

(a) ALLOWANCE OF CREDIT.—In the case of an individual who is a first-time homebuyer of a principal residence in the District of Columbia during any taxable year, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to so much of the purchase price of the residence as does not exceed $5,000.

(b) LIMITATION BASED ON MODIFIED ADJUSTED GROSS INCOME.—

(1) IN GENERAL.—The amount allowable as a credit under subsection (a) (determined without regard to this subsection) for the taxable year shall be reduced (but not below zero) by the amount which bears the same ratio to the credit so allowable as—

(A) the excess (if any) of—

(i) the taxpayer's modified adjusted gross income for such taxable year, over

(ii) $70,000 ($110,000 in the case of a joint return), bears to

(B) $20,000.

(2) MODIFIED ADJUSTED GROSS INCOME.—For purposes of paragraph (1), the term "modified adjusted gross income" means the adjusted gross income of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933.

(c) FIRST-TIME HOMEBUYER.—For purposes of this section—

(1) IN GENERAL.—The term "first-time homebuyer" has the same meaning as when used in section 72(t)(8)(D)(i), except that "principal residence in the District of Columbia during the 1-year period" shall be substituted for "principal residence during the 2-year period" in subclause (I) thereof.

(2) One-time only.—If an individual is treated as a first-time homebuyer with respect to any principal residence, such individual may not be treated as a first-time homebuyer with respect to any other principal residence.

(3) Principal residence.—The term "principal residence" has the same meaning as when used in section 121.

(d) Carryover of Credit.—If the credit allowable under subsection (a) exceeds the limitation imposed by section 26(a) for such taxable year reduced by the sum of the credits allowable under subpart A of part IV of subchapter A (other than this section), such excess shall be carried to the succeeding taxable year and added to the credit allowable under subsection (a) for such taxable year.

(e) Special Rules.—For purposes of this section—

(1) Allocation of dollar limitation.—

(A) Married individuals filing separately.—In the case of a married individual filing a separate return, subsection (a) shall be applied by substituting "$2,500" for "$5,000".

(B) Other taxpayers.—If 2 or more individuals who are not married purchase a principal residence, the amount of the credit allowed under subsection (a) shall be allocated among such individuals in such manner as the Secretary may prescribe, except that the total amount of the credits allowed to all such individuals shall not exceed $5,000.

(2) Purchase.—

(A) In general.—The term "purchase" means any acquisition, but only if—

(i) the property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b) (but, in applying section 267(b) and (c) for purposes of this section, paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants), and

(ii) the basis of the property in the hands of the person acquiring it is not determined—

(I) in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or

(II) under section 1014(a) (relating to property acquired from a decedent).

(B) Construction.—A residence which is constructed by the taxpayer shall be treated as purchased by the taxpayer.

(3) Purchase price.—The term "purchase price" means the adjusted basis of the principal residence on the date of acquisition (within the meaning of section 72(t)(8)(D)(iii)).

(f) Reporting.—If the Secretary requires information reporting under section 6045 by a person described in subsection (e)(2) thereof to verify the eligibility of taxpayers for the credit allowable by this section, the exception provided by section 6045(e)(5) shall not apply.

(g) Credit Treated as Nonrefundable Personal Credit.—For purposes of this title, the credit allowed by this section shall be treated as a credit allowable under subpart A of part IV of subchapter A of this chapter.

(h) Basis Adjustment.—For purposes of this subtitle, if a credit is allowed under this section with respect to the purchase of any residence, the basis of such residence shall be reduced by the amount of the credit so allowed.

(i) Termination.—This section shall not apply to any property purchased after December 31, 2000.

[CCH Explanation at ¶ 381, 383, 385 and 387. Committee Reports at ¶ 10,465.]

Amendment Notes

Act Sec. 701(a) added a new Code Sec. 1400C to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5403] CODE SEC. 1402. DEFINITIONS.

* * *

(k) Codification of Treatment of Certain Termination Payments Received by Former Insurance Salesmen.—Nothing in subsection (a) shall be construed as including in the net earnings from self-employment of an individual any amount received during the taxable year from an insurance company on account of services performed by such individual as an insurance salesman for such company if—

(1) such amount is received after termination of such individual's agreement to perform such services for such company,

(2) such individual performs no services for such company after such termination and before the close of such taxable year,

(3) such individual enters into a covenant not to compete against such company which applies to at least the 1-year period beginning on the date of such termination, and

(4) the amount of such payment—

(A) depends primarily on policies sold by or credited to the account of such individual during the last year of such agreement or the extent to which such policies remain in force for some period after such termination, or both, and

(B) does not depend to any extent on length of service or overall earnings from services performed for such company (without regard to whether eligibility for payment depends on length of service).

* * *

[CCH Explanation at ¶ 463 and 1117. Committee Reports at ¶ 10,640 and 10,675.]

Amendment Notes

Act Sec. 922(a) amended Code Sec. 1402 by adding a new subsection (k) to read as above.

The above amendment applies to payments after December 31, 1997.

Act Sec. 935 provides:

No temporary or final regulation with respect to the definition of a limited partner under section 1402(a)(13) of the Internal Revenue Code of 1986 may be issued or made effective before July 1, 1998.

[¶ 5405] CODE SEC. 1441. WITHHOLDING OF TAX ON NONRESIDENT ALIENS.

* * *

(g) CROSS REFERENCE.—

For provision treating *85 percent* of social security benefits as subject to withholding under this section, see section 871(a)(3).

* * *

Amendment Notes

Act Sec. 1604(g)(3) amended Code Sec. 1441(g) by striking "one-half" and inserting "85 percent".

The above amendment is effective on the date of the enactment of this Act.

[¶ 5407] CODE SEC. 1445. WITHHOLDING OF TAX ON DISPOSITIONS OF UNITED STATES REAL PROPERTY INTERESTS.

* * *

(e) SPECIAL RULES RELATING TO DISTRIBUTIONS, ETC., BY CORPORATIONS, PARTNERSHIPS, TRUSTS, OR ESTATES.—

(1) CERTAIN DOMESTIC PARTNERSHIPS, TRUSTS, AND ESTATES.—In the case of any disposition of a United States real property interest as defined in section 897(c) (other than a disposition described in paragraph (4) or (5)) by a domestic partnership, domestic trust, or domestic estate, such partnership, the trustee or such trust, or the executor of such estate (as the case may be) shall be required to deduct and withhold under subsection (a) a tax equal to 35 percent (or, to the extent provided in regulations, *20 percent*) of the gain realized to the extent such gain—

(A) is allocable to a foreign person who is a partner or beneficiary of such partnership, trust, or estate, or

(B) is allocable to a portion of the trust treated as owned by a foreign person under subpart E of Part I of subchapter J.

* * *

[CCH Explanation at ¶ 303. Committee Reports at ¶ 10,295.]

Amendment Notes

Act Sec. 311(c)(1) amended Code Sec. 1445(e)(1) by striking "28 percent" and inserting "20 percent".

The above amendment applies only to amounts paid after the date of the enactment of this Act.

[¶ 5409] CODE SEC. 1491. *[REPEALED.]*

* * *

[CCH Explanation at ¶ 968. Committee Reports at ¶ 11,735.]

Amendment Notes

Act Sec. 1131(a) repealed Chapter 5 (Code Secs. 1491-1494). Prior to repeal, Code Sec. 1491 read as follows:

SEC. 1491. IMPOSITION OF TAX.

There is hereby imposed on the transfer of property by a citizen or resident of the United States, or by a domestic corporation or partnership, or by an estate or trust which is not a foreign estate or trust, to a foreign corporation as paid-in surplus or as a contribution to capital, or to a foreign estate

or trust, or to a foreign partnership, an excise tax equal to 35 percent of the excess of—

(1) the fair market value of the property so transferred, over

(2) the sum of—

(A) the adjusted basis (for determining gain) of such property in the hands of the transferor, plus

(B) the amount of the gain recognized to the transferor at the time of the transfer.

If a trust which is not a foreign trust becomes a foreign trust, such trust shall be treated for purposes of this section as having transferred, immediately before becoming a foreign trust, all of its assets to a foreign trust.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5412] CODE SEC. 1492. *[REPEALED.]*

* * *

[CCH Explanation at ¶ 968. Committee Reports at ¶ 11,735.]

Amendment Notes

Act Sec. 1131(a) repealed Code Sec. 1492. Prior to repeal, Code Sec. 1492 read as follows:

SEC. 1492. NONTAXABLE TRANSFERS.

The tax imposed by section 1491 shall not apply—

(1) If the transferee is an organization exempt from income tax under part I of subchapter F of chapter 1 (other than an organization described in section 401(a)); or

(2) To a transfer—

(A) described in section 367, or

(B) not described in section 367 but with respect to which the taxpayer elects (before the transfer) the application of principles similar to the principles of section 367, or

(3) To a transfer for which an election has been made under section 1057.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5415] CODE SEC. 1494. *[REPEALED.]*

* * *

[CCH Explanation at ¶ 968. Committee Reports at ¶ 11,735.]

Amendment Notes

Act Sec. 1131(a) repealed Code Sec. 1494. Prior to repeal, Code Sec. 1494 read as follows:

SEC. 1494. PAYMENT AND COLLECTION.

(a) TIME FOR PAYMENT.—The tax imposed by section 1491 shall, without assessment or notice and demand, be due and payable by the transferor at the time of the transfer, and shall be assessed, collected, and paid under regulations prescribed by the Secretary.

(b) ABATEMENT OR REFUND.—Under regulations prescribed by the Secretary, the tax may be abated, remitted, or refunded if the taxpayer, after the transfer, elects the application of principles similar to the principles of section 367.

(c) PENALTY.—In the case of any failure to file a return required by the Secretary with respect to any transfer described in section 1491, the person required to file such return shall be liable for the penalties provided in section 6677 in the same manner as if such failure were a failure to file a notice under section 6048(a).

The above amendment is effective on the date of the enactment of this Act.

[¶ 5417] CODE SEC. 2001. IMPOSITION AND RATE OF TAX.

* * *

(c) RATE SCHEDULE.—

* * *

(2) PHASEOUT OF GRADUATED RATES AND UNIFIED CREDIT.—The tentative tax determined under paragraph (1) shall be increased by an amount equal to 5 percent of so much of the amount (with respect to which the tentative tax is to be computed) as exceeds $10,000,000 but does not exceed *the amount at which the average tax rate under this section is 55 percent.*

* * *

Amendment Notes

Act Sec. 501(a)(1)(D) amended Code Sec. 2001(c)(2) by striking "$21,040,000" and inserting "the amount at which the average tax rate under this section is 55 percent".

The above amendment applies to the estates of decedents dying, and gifts made, after December 31, 1997.

(f) VALUATION OF GIFTS.—If—

(1) the time has expired within which a tax may be assessed under chapter 12 (or under corresponding provisions of prior laws) on the transfer of property by gift made during a preceding calendar period (as defined in section 2502(b)), and

(2) the value of such gift is shown on the return for such preceding calendar period or is disclosed in such return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such gift, the value of such gift shall, for purposes of computing the tax under this chapter, be the value of such gift as finally determined for purposes of chapter 12.

* * *

[CCH Explanation at ¶ 201 and 255. Committee Reports at ¶ 10,365 and 10,395.]

Amendment Notes

Act Sec. 506(a) amended Code Sec. 2001 by adding at the end a new subsection (f) to read as above.

The above amendment applies to gifts made after the date of the enactment of this Act.

[¶ 5419] CODE SEC. 2010. UNIFIED CREDIT AGAINST ESTATE TAX.

(a) GENERAL RULE.—A credit of *the applicable credit amount* shall be allowed to the estate of every decedent against the tax imposed by section 2001.

* * *

Amendment Notes

Act Sec. 501(a)(1)(A) amended Code Sec. 2010(a) by striking "$192,800" and inserting "the applicable credit amount".

The above amendment applies to the estates of decedents dying, and gifts made, after December 31, 1997.

(c) APPLICABLE CREDIT AMOUNT.—For purposes of this section, the applicable credit amount is the amount of the tentative tax which would be determined under the rate schedule set forth in section 2001(c) if the amount with respect to which such tentative tax is to be computed were the applicable exclusion amount determined in accordance with the following table:

In the case of estates of decedents dying, and gifts made, during:	*The applicable exclusion amount is:*
1998	*$ 625,000*
1999	*$ 650,000*
2000 and 2001	*$ 675,000*
2002 and 2003	*$ 700,000*
2004	*$ 850,000*
2005	*$ 950,000*
2006 or thereafter	*$1,000,000*

Amendment Notes

Act Sec. 501(a)(1)(B) amended Code Sec. 2010 by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) a new subsection (c) to read as above.

The above amendment applies to the estates of decedents dying, and gifts made, after December 31, 1997.

(d) LIMITATION BASED ON AMOUNT OF TAX.—The amount of the credit allowed by subsection (a) shall not exceed the amount of the tax imposed by section 2001.

* * *

[CCH Explanation at ¶ 201. Committee Reports at ¶ 10,365.]

Amendment Notes

Act Sec. 501(a)(1)(B) amended Code Sec. 2010 by redesignating subsection (c) as subsection (d).

The above amendment applies to the estates of decedents dying, and gifts made, after December 31, 1997.

[¶ 5421] CODE SEC. 2013. CREDIT FOR TAX ON PRIOR TRANSFERS.

* * *

(g) *[Stricken.]*

* * *

[CCH Explanation at ¶ 714. Committee Reports at ¶ 11,465.]

Amendment Notes

Act Sec. 1073(b)(2) amended Code Sec. 2013 by striking subsection (g). Prior to being stricken, Code Sec. 2013(g) read as follows:

(g) TREATMENT OF ADDITIONAL TAX UNDER SECTION 4980A.—For purposes of this section, the estate tax paid shall not include any portion of such tax attributable to section 4980A(d).

The above amendment applies to estates of decedents dying after December 31, 1996.

[¶ 5423] CODE SEC. 2031. DEFINITION OF GROSS ESTATE.

* * *

(c) ESTATE TAX WITH RESPECT TO LAND SUBJECT TO A QUALIFIED CONSERVATION EASEMENT.—

(1) IN GENERAL.—If the executor makes the election described in paragraph (6), then, except as otherwise provided in this subsection, there shall be excluded from the gross estate the lesser of—

(A) the applicable percentage of the value of land subject to a qualified conservation easement, reduced by the amount of any deduction under section 2055(f) with respect to such land, or

(B) the exclusion limitation.

(2) Applicable percentage.—For purposes of paragraph (1), the term "applicable percentage" means 40 percent reduced (but not below zero) by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30 percent of the value of the land (determined without regard to the value of such easement and reduced by the value of any retained development right (as defined in paragraph (5)).

(3) Exclusion limitation.—For purposes of paragraph (1), the exclusion limitation is the limitation determined in accordance with the following table:

In the case of estates of decedents dying during:	*The exclusion limitation is:*
1998	*$ 100,000*
1999	*$ 200,000*
2000	*$ 300,000*
2001	*$ 400,000*
2002 or thereafter	*$ 500,000*

(4) Treatment of certain indebtedness.—

(A) In general.—The exclusion provided in paragraph (1) shall not apply to the extent that the land is debt-financed property.

(B) Definitions.—For purposes of this paragraph—

(i) Debt-financed property.—The term "debt-financed property" means any property with respect to which there is an acquisition indebtedness (as defined in clause (ii)) on the date of the decedent's death.

(ii) Acquisition indebtedness.—The term "acquisition indebtedness" means, with respect to debt-financed property, the unpaid amount of—

(I) the indebtedness incurred by the donor in acquiring such property,

(II) the indebtedness incurred before the acquisition of such property if such indebtedness would not have been incurred but for such acquisition,

(III) the indebtedness incurred after the acquisition of such property if such indebtedness would not have been incurred but for such acquisition and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition, and

(IV) the extension, renewal, or refinancing of an acquisition indebtedness.

(5) Treatment of retained development right.—

(A) In general.—Paragraph (1) shall not apply to the value of any development right retained by the donor in the conveyance of a qualified conservation easement.

(B) Termination of retained development right.—If every person in being who has an interest (whether or not in possession) in the land executes an agreement to extinguish permanently some or all of any development rights (as defined in subparagraph (D)) retained by the donor on or before the date for filing the return of the tax imposed by section 2001, then any tax imposed by section 2001 shall be reduced accordingly. Such agreement shall be filed with the return of the tax imposed by section 2001. The agreement shall be in such form as the Secretary shall prescribe.

(C) Additional tax.—Any failure to implement the agreement described in subparagraph (B) not later than the earlier of—

(i) the date which is 2 years after the date of the decedent's death, or

(ii) the date of the sale of such land subject to the qualified conservation easement,

shall result in the imposition of an additional tax in the amount of the tax which would have been due on the retained development rights subject to such agreement. Such additional tax shall be due and payable on the last day of the 6th month following such date.

(D) Development right defined.—For purposes of this paragraph, the term "development right" means any right to use the land subject to the qualified conservation easement in which such right is retained for any commercial purpose which is not subordinate to and directly supportive of the use of such land as a farm for farming purposes (within the meaning of section 2032A(e)(5)).

(6) Election.—The election under this subsection shall be made on the return of the tax imposed by section 2001. Such an election, once made, shall be irrevocable.

(7) Calculation of estate tax due.—An executor making the election described in paragraph (6) shall, for purposes of calculating the amount of tax imposed by section 2001, include the value of any development right (as defined in paragraph (5)) retained by the donor in the conveyance of such qualified conservation easement. The computation of tax on any retained development right prescribed in this paragraph shall be done in such manner and on such forms as the Secretary shall prescribe.

(8) Definitions.—For purposes of this subsection—

(A) Land subject to a qualified conservation easement.—The term "land subject to a qualified conservation easement" means land—

(i) which is located—

(I) in or within 25 miles of an area which, on the date of the decedent's death, is a metropolitan area (as defined by the Office of Management and Budget),

(II) in or within 25 miles of an area which, on the date of the decedent's death, is a national park or wilderness area designated as part of the National Wilderness Preservation System (unless it is determined by the Secretary that land in or within 25 miles of such a park or wilderness area is not under significant development pressure), or

(III) in or within 10 miles of an area which, on the date of the decedent's death, is an Urban National Forest (as designated by the Forest Service),

(ii) which was owned by the decedent or a member of the decedent's family at all times during the 3-year period ending on the date of the decedent's death, and

(iii) with respect to which a qualified conservation easement has been made by an individual described in subparagraph (C), as of the date of the election described in paragraph (6).

(B) Qualified conservation easement.—The term "qualified conservation easement" means a qualified conservation contribution (as defined in section 170(h)(1)) of a qualified real property interest (as defined in section 170(h)(2)(C)), except that clause (iv) of section 170(h)(4)(A) shall not apply, and the restriction on the use of such interest described in section 170(h)(2)(C) shall include a prohibition on more than a de minimis use for a commercial recreational activity.

(C) Individual described.—An individual is described in this subparagraph if such individual is—

(i) the decedent,

(ii) a member of the decedent's family,

(iii) the executor of the decedent's estate, or

(iv) the trustee of a trust the corpus of which includes the land to be subject to the qualified conservation easement.

(D) Member of family.—The term "member of the decedent's family" means any member of the family (as defined in section 2032A(e)(2)) of the decedent.

(9) Application of this section to interests in partnerships, corporations, and trusts.—This section shall apply to an interest in a partnership, corporation, or trust if at least 30 percent of the entity is owned (directly or indirectly) by the decedent, as determined under the rules described in section 2033A(e)(3).

Amendment Notes

Act Sec. 508(a) amended Code Sec. 2031 by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) a new subsection (c) to read as above.

The above amendment applies to estates of decedents dying after December 31, 1997.

(d) Cross Reference.—

For executor's right to be furnished on request a statement regarding any valuation made by the Secretary within the gross estate, see section 7517.

* * *

[CCH Explanation at ¶ 214. Committee Reports at ¶ 10,420.]

Amendment Notes

Act Sec. 508(a) amended Code Sec. 2031 by redesignating subsection (c) as subsection (d).

The above amendment applies to estates of decedents dying after December 31, 1997.

[¶ 5425] CODE SEC. 2032A. VALUATION OF CERTAIN FARM, ETC., REAL PROPERTY.

(a) VALUE BASED ON USE UNDER WHICH PROPERTY QUALIFIES.—

* * *

(3) INFLATION ADJUSTMENT.—In the case of estates of decedents dying in a calendar year after 1998, the $750,000 amount contained in paragraph (2) shall be increased by an amount equal to—

(A) $750,000, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 1997" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the next lowest multiple of $10,000.

Amendment Notes

Act Sec. 501(b) amended Code Sec. 2032A(a) by adding a new paragraph (3) to read as above.

The above amendment applies to the estates of decedents dying, and gifts made, after December 31, 1997.

(b) QUALIFIED REAL PROPERTY.—

* * *

(5) SPECIAL RULES FOR SURVIVING SPOUSES.—

(A) IN GENERAL.—If property is qualified real property with respect to a decedent (hereinafter in this paragraph referred to as the "first decedent") and such property was acquired from or passed from the first decedent to the surviving spouse of the first decedent, for purposes of applying this subsection and subsection (c) in the case of the estate of such surviving spouse, active management of the farm or other business by the surviving spouse shall be treated as material participation by such surviving spouse in the operation of such farm or business.

* * *

Amendment Notes

Act Sec. 504(b) amended Code Sec. 2032A(b)(5)(A) is amended by striking the last sentence. Prior to being stricken, the last sentence of Code Sec. 2032A(b)(5)(A) read as follows:

For purposes of subsection (c), such surviving spouse shall not be treated as failing to use such property in a qualified use solely because such spouse rents such property to a member of such spouse's family on a net cash basis.

The above amendment applies with respect to leases entered into after December 31, 1976.

(c) TAX TREATMENT OF DISPOSITIONS AND FAILURES TO USE FOR QUALIFIED USE.—

* * *

(7) SPECIAL RULES.—

* * *

(E) CERTAIN RENTS TREATED AS QUALIFIED USE.—For purposes of this subsection, a surviving spouse or lineal descendant of the decedent shall not be treated as failing to use qualified real property in a qualified use solely because such spouse or descendant rents such property to a member of the family of such spouse or descendant on a net cash basis. For purposes of the preceding sentence, a legally adopted child of an individual shall be treated as the child of such individual by blood.

(8) QUALIFIED CONSERVATION CONTRIBUTION IS NOT A DISPOSITION.—A qualified conservation contribution (as defined in section 170(h)) by gift or otherwise shall not be deemed a disposition under subsection (c)(1)(A).

Amendment Notes

Act Sec. 504(a) amended Code Sec. 2032A(c)(7) by adding a new subparagraph (E) to read as above.

The above amendment applies with respect to leases entered into after December 31, 1976.

Act Sec. 508(c) amended Code Sec. 2032A(c) by adding a new paragraph (8) to read as above.

The above amendment applies to easements granted after December 31, 1997.

(d) ELECTION; AGREEMENT.—

* * *

(3) MODIFICATION OF ELECTION AND AGREEMENT TO BE PERMITTED.—The Secretary shall prescribe procedures which provide that in any case in which the executor makes an election under paragraph (1) (and submits the agreement referred to in paragraph (2)) within the time prescribed therefor, but—

(A) the notice of election, as filed, does not contain all required information, or

(B) signatures of 1 or more persons required to enter into the agreement described in paragraph (2) are not included on the agreement as filed, or the agreement does not contain all required information,

the executor will have a reasonable period of time (not exceeding 90 days) after notification of such failures to provide such information or signatures.

* * *

[CCH Explanation at ¶ 204, 214, 229 and 231. Committee Reports at ¶ 10,370, 10,385, 10,420 and 12,675.]

Amendment Notes

Act Sec. 1313(a) amended Code Sec. 2032A(d)(3) to read as above. Prior to amendment, Code Sec. 2032A(d)(3) read as follows:

(3) MODIFICATION OF ELECTION AND AGREEMENT TO BE PERMITTED.—The Secretary shall prescribe procedures which provide that in any case in which—

(A) the executor makes an election under paragraph (1) within the time prescribed for filing such election, and

(B) substantially complies with the regulations prescribed by the Secretary with respect to such election, but—

(i) the notice of election, as filed, does not contain all required information, or

(ii) signatures of 1 or more persons required to enter into the agreement described in paragraph (2) are not included on the agreement as filed, or the agreement does not contain all required information,

the executor will have a reasonable period of time (not exceeding 90 days) after notification of such failures to provide such information or agreements.

The above amendment applies to estates of decedents dying after the date of the enactment of this Act.

[¶ 5427] *CODE SEC. 2033A. FAMILY-OWNED BUSINESS EXCLUSION.*

(a) IN GENERAL.—In the case of an estate of a decedent to which this section applies, the value of the gross estate shall not include the lesser of—

(1) the adjusted value of the qualified family-owned business interests of the decedent otherwise includible in the estate, or

(2) the excess of $1,300,000 over the applicable exclusion amount under section 2010(c) with respect to such estate.

(b) ESTATES TO WHICH SECTION APPLIES.—

(1) IN GENERAL.—This section shall apply to an estate if—

(A) the decedent was (at the date of the decedent's death) a citizen or resident of the United States,

(B) the executor elects the application of this section and files the agreement referred to in subsection (h),

(C) the sum of—

(i) the adjusted value of the qualified family-owned business interests described in paragraph (2), plus

(ii) the amount of the gifts of such interests determined under paragraph (3),

exceeds 50 percent of the adjusted gross estate, and

(D) during the 8-year period ending on the date of the decedent's death there have been periods aggregating 5 years or more during which—

(i) such interests were owned by the decedent or a member of the decedent's family, and

(ii) there was material participation (within the meaning of section 2032A(e)(6)) by the decedent or a member of the decedent's family in the operation of the business to which such interests relate.

(2) INCLUDIBLE QUALIFIED FAMILY-OWNED BUSINESS INTERESTS.—The qualified family-owned business interests described in this paragraph are the interests which—

(A) are included in determining the value of the gross estate (without regard to this section), and

(B) are acquired by any qualified heir from, or passed to any qualified heir from, the decedent (within the meaning of section 2032A(e)(9)).

(3) INCLUDIBLE GIFTS OF INTERESTS.—The amount of the gifts of qualified family-owned business interests determined under this paragraph is the excess of—

(A) the sum of—

(i) the amount of such gifts from the decedent to members of the decedent's family taken into account under subsection 2001(b)(1)(B), plus

(ii) the amount of such gifts otherwise excluded under section 2503(b),

to the extent such interests are continuously held by members of such family (other than the decedent's spouse) between the date of the gift and the date of the decedent's death, over

(B) the amount of such gifts from the decedent to members of the decedent's family otherwise included in the gross estate.

(c) Adjusted Gross Estate.—For purposes of this section, the term "adjusted gross estate" means the value of the gross estate (determined without regard to this section)—

(1) reduced by any amount deductible under paragraph (3) or (4) of section 2053(a), and

(2) increased by the excess of—

(A) the sum of—

(i) the amount of gifts determined under subsection (b)(3), plus

(ii) the amount (if more than de minimis) of other transfers from the decedent to the decedent's spouse (at the time of the transfer) within 10 years of the date of the decedent's death, plus

(iii) the amount of other gifts (not included under clause (i) or (ii)) from the decedent within 3 years of such date, other than gifts to members of the decedent's family otherwise excluded under section 2503(b), over

(B) the sum of the amounts described in clauses (i), (ii), and (iii) of subparagraph (A) which are otherwise includible in the gross estate.

For purposes of the preceding sentence, the Secretary may provide that de minimis gifts to persons other than members of the decedent's family shall not be taken into account.

(d) Adjusted Value of the Qualified Family-Owned Business Interests.—For purposes of this section, the adjusted value of any qualified family-owned business interest is the value of such interest for purposes of this chapter (determined without regard to this section), reduced by the excess of—

(1) any amount deductible under paragraph (3) or (4) of section 2053(a), over

(2) the sum of—

(A) any indebtedness on any qualified residence of the decedent the interest on which is deductible under section 163(h)(3), plus

(B) any indebtedness to the extent the taxpayer establishes that the proceeds of such indebtedness were used for the payment of educational and medical expenses of the decedent, the decedent's spouse, or the decedent's dependents (within the meaning of section 152), plus

(C) any indebtedness not described in subparagraph (A) or (B), to the extent such indebtedness does not exceed $10,000.

(e) Qualified Family-Owned Business Interest.—

(1) In general.—For purposes of this section, the term "qualified family-owned business interest" means—

(A) an interest as a proprietor in a trade or business carried on as a proprietorship, or

(B) an interest in an entity carrying on a trade or business, if—

(i) at least—

(I) 50 percent of such entity is owned (directly or indirectly) by the decedent and members of the decedent's family,

(II) 70 percent of such entity is so owned by members of 2 families, or

(III) 90 percent of such entity is so owned by members of 3 families, and

(ii) for purposes of subclause (II) or (III) of clause (i), at least 30 percent of such entity is so owned by the decedent and members of the decedent's family.

(2) Limitation.—Such term shall not include—

(A) any interest in a trade or business the principal place of business of which is not located in the United States,

(B) any interest in an entity, if the stock or debt of such entity or a controlled group (as defined in section 267(f)(1)) of which such entity was a member was readily tradable on an

established securities market or secondary market (as defined by the Secretary) at any time within 3 years of the date of the decedent's death,

(C) any interest in a trade or business not described in section 542(c)(2), if more than 35 percent of the adjusted ordinary gross income of such trade or business for the taxable year which includes the date of the decedent's death would qualify as personal holding company income (as defined in section 543(a)),

(D) that portion of an interest in a trade or business that is attributable to—

(i) cash or marketable securities, or both, in excess of the reasonably expected day-to-day working capital needs of such trade or business, and

(ii) any other assets of the trade or business (other than assets used in the active conduct of a trade or business described in section 542(c)(2)), which produce, or are held for the production of, income of which is described in section 543(a) or in section 954(c)(1) (determined without regard to subparagraph (A) thereof and by substituting "trade or business" for "controlled foreign corporation").

(3) RULES REGARDING OWNERSHIP.—

(A) OWNERSHIP OF ENTITIES.—For purposes of paragraph (1)(B)—

(i) CORPORATIONS.—Ownership of a corporation shall be determined by the holding of stock possessing the appropriate percentage of the total combined voting power of all classes of stock entitled to vote and the appropriate percentage of the total value of shares of all classes of stock.

(ii) PARTNERSHIPS.—Ownership of a partnership shall be determined by the owning of the appropriate percentage of the capital interest in such partnership.

(B) OWNERSHIP OF TIERED ENTITIES.—For purposes of this section, if by reason of holding an interest in a trade or business, a decedent, any member of the decedent's family, any qualified heir, or any member of any qualified heir's family is treated as holding an interest in any other trade or business—

(i) such ownership interest in the other trade or business shall be disregarded in determining if the ownership interest in the first trade or business is a qualified family-owned business interest, and

(ii) this section shall be applied separately in determining if such interest in any other trade or business is a qualified family-owned business interest.

(C) INDIVIDUAL OWNERSHIP RULES.—For purposes of this section, an interest owned, directly or indirectly, by or for an entity described in paragraph (1)(B) shall be considered as being owned proportionately by or for the entity's shareholders, partners, or beneficiaries. A person shall be treated as a beneficiary of any trust only if such person has a present interest in such trust.

(f) TAX TREATMENT OF FAILURE TO MATERIALLY PARTICIPATE IN BUSINESS OR DISPOSITIONS OF INTERESTS.—

(1) IN GENERAL.—There is imposed an additional estate tax if, within 10 years after the date of the decedent's death and before the date of the qualified heir's death—

(A) the material participation requirements described in section 2032A(c)(6)(B) are not met with respect to the qualified family-owned business interest which was acquired (or passed) from the decedent,

(B) the qualified heir disposes of any portion of a qualified family-owned business interest (other than by a disposition to a member of the qualified heir's family or through a qualified conservation contribution under section 170(h)),

(C) the qualified heir loses United States citizenship (within the meaning of section 877) or with respect to whom an event described in subparagraph (A) or (B) of section 877(e)(1) occurs, and such heir does not comply with the requirements of subsection (g), or

(D) the principal place of business of a trade or business of the qualified family-owned business interest ceases to be located in the United States.

(2) ADDITIONAL ESTATE TAX.—

(A) IN GENERAL.—The amount of the additional estate tax imposed by paragraph (1) shall be equal to—

(i) the applicable percentage of the adjusted tax difference attributable to the qualified family-owned business interest (as determined under rules similar to the rules of section 2032A(c)(2)(B)), plus

(ii) interest on the amount determined under clause (i) at the underpayment rate established under section 6621 for the period beginning on the date the estate tax liability was due under this chapter and ending on the date such additional estate tax is due.

(B) APPLICABLE PERCENTAGE.—For purposes of this paragraph, the applicable percentage shall be determined under the following table:

If the event described in paragraph (1) occurs in the following year of material participation:	The applicable percentage is:
1 through 6	100
7	80
8	60
9	40
10	20

(g) SECURITY REQUIREMENTS FOR NONCITIZEN QUALIFIED HEIRS.—

(1) IN GENERAL.—Except upon the application of subparagraph (F) or (M) of subsection (i)(3), if a qualified heir is not a citizen of the United States, any interest under this section passing to or acquired by such heir (including any interest held by such heir at a time described in subsection (f)(1)(C)) shall be treated as a qualified family-owned business interest only if the interest passes or is acquired (or is held) in a qualified trust.

(2) QUALIFIED TRUST.—The term "qualified trust" means a trust—

(A) which is organized under, and governed by, the laws of the United States or a State, and

(B) except as otherwise provided in regulations, with respect to which the trust instrument requires that at least 1 trustee of the trust be an individual citizen of the United States or a domestic corporation.

(h) AGREEMENT.—The agreement referred to in this subsection is a written agreement signed by each person in being who has an interest (whether or not in possession) in any property designated in such agreement consenting to the application of subsection (f) with respect to such property.

(i) OTHER DEFINITIONS AND APPLICABLE RULES.—For purposes of this section—

(1) QUALIFIED HEIR.—The term "qualified heir"—

(A) has the meaning given to such term by section 2032A(e)(1), and

(B) includes any active employee of the trade or business to which the qualified family-owned business interest relates if such employee has been employed by such trade or business for a period of at least 10 years before the date of the decedent's death.

(2) MEMBER OF THE FAMILY.—The term "member of the family" has the meaning given to such term by section 2032A(e)(2).

(3) APPLICABLE RULES.—Rules similar to the following rules shall apply:

(A) Section 2032A(b)(4) (relating to decedents who are retired or disabled).

(B) Section 2032A(b)(5) (relating to special rules for surviving spouses).

(C) Section 2032A(c)(2)(D) (relating to partial dispositions).

(D) Section 2032A(c)(3) (relating to only 1 additional tax imposed with respect to any 1 portion).

(E) Section 2032A(c)(4) (relating to due date).

(F) Section 2032A(c)(5) (relating to liability for tax; furnishing of bond).

(G) Section 2032A(c)(7) (relating to no tax if use begins within 2 years; active management by eligible qualified heir treated as material participation).

(H) Paragraphs (1) and (3) of section 2032A(d) (relating to election; agreement).

(I) Section 2032A(e)(10) (relating to community property).

(J) Section 2032A(e)(14) (relating to treatment of replacement property acquired in section 1031 or 1033 transactions).

(K) Section 2032A(f) (relating to statute of limitations).

(L) Section 6166(b)(3) (relating to farmhouses and certain other structures taken into account).

(M) Subparagraphs (B), (C), and (D) of section 6166(g)(1) (relating to acceleration of payment).

(N) Section 6324B (relating to special lien for additional estate tax).

* * *

[CCH Explanation at ¶ 215. Committee Reports at ¶ 10,375.]

Amendment Notes

Act Sec. 502(a) amended part III of subchapter A of chapter 11 by inserting after Code Sec. 2033 a new Code Sec. 2033A to read as above.

The above amendment applies to estates of decedents dying after December 31, 1997.

[¶ 5429] *CODE SEC. 2035. ADJUSTMENTS FOR CERTAIN GIFTS MADE WITHIN 3 YEARS OF DECEDENT'S DEATH.*

(a) INCLUSION OF CERTAIN PROPERTY IN GROSS ESTATE.—If—

(1) the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and

(2) the value of such property (or an interest therein) would have been included in the decedent's gross estate under section 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death, the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

(b) INCLUSION OF GIFT TAX ON GIFTS MADE DURING 3 YEARS BEFORE DECEDENT'S DEATH.—The amount of the gross estate (determined without regard to this subsection) shall be increased by the amount of any tax paid under chapter 12 by the decedent or his estate on any gift made by the decedent or his spouse during the 3-year period ending on the date of the decedent's death.

(c) OTHER RULES RELATING TO TRANSFERS WITHIN 3 YEARS OF DEATH.—

(1) IN GENERAL.—For purposes of—

(A) section 303(b) (relating to distributions in redemption of stock to pay death taxes),

(B) section 2032A (relating to special valuation of certain farms, etc., real property), and

(C) subchapter C of chapter 64 (relating to lien for taxes),

the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, during the 3-year period ending on the date of the decedent's death.

(2) COORDINATION WITH SECTION 6166.—An estate shall be treated as meeting the 35 percent of adjusted gross estate requirement of section 6166(a)(1) only if the estate meets such requirement both with and without the application of paragraph (1).

(3) MARITAL AND SMALL TRANSFERS.—Paragraph (1) shall not apply to any transfer (other than a transfer with respect to a life insurance policy) made during a calendar year to any donee if the decedent was not required by section 6019 (other than by reason of section 6019(2)) to file any gift tax return for such year with respect to transfers to such donee.

(d) EXCEPTION.—Subsection (a) shall not apply to any bona fide sale for an adequate and full consideration in money or money's worth.

(e) TREATMENT OF CERTAIN TRANSFERS FROM REVOCABLE TRUSTS.—For purposes of this section and section 2038, any transfer from any portion of a trust during any period that such portion was treated under section 676 as owned by the decedent by reason of a power in the grantor (determined without regard to section 672(e)) shall be treated as a transfer made directly by the decedent.

* * *

[CCH Explanation at ¶ 210. Committee Reports at ¶ 12,660.]

Amendment Notes

Act Sec. 1310(a) amended Code Sec. 2035 to read as above. Prior to amendment, Code Sec. 2035 read as follows:

SEC. 2035. ADJUSTMENTS FOR GIFTS MADE WITHIN 3 YEARS OF DECEDENT'S DEATH.

(a) INCLUSION OF GIFTS MADE BY DECEDENT.—Except as provided in subsection (b), the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, during the 3-year period ending on the date of the decedent's death.

(b) EXCEPTIONS.—Subsection (a) shall not apply—

(1) to any bona fide sale for an adequate and full consideration in money or money's worth, and

(2) to any gift to a donee made during a calendar year if the decedent was not required by section 6019 (other than by reason of section 6019(2)) to file any gift tax return for such year with respect to gifts to such donee. Paragraph (2) shall

not apply to any transfer with respect to a life insurance policy.

(c) INCLUSION OF GIFT TAX ON CERTAIN GIFTS MADE DURING 3 YEARS BEFORE DECEDENT'S DEATH.—The amount of the gross estate (determined without regard to this subsection) shall be increased by the amount of any tax paid under chapter 12 by the decedent or his estate on any gift made by the decedent or his spouse after December 31, 1976, and during the 3-year period ending on the date of the decedent's death.

(d) DECEDENTS DYING AFTER 1981.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, subsection (a) shall not apply to the estate of a decedent dying after December 31, 1981.

(2) EXCEPTIONS FOR CERTAIN TRANSFERS.—Paragraph (1) of this subsection and paragraph (2) of subsection (b) shall not apply to a transfer of an interest in property which is included in the value of the gross estate under section 2036, 2037, 2038, or 2042 or would have been included under any of such sections if such interest had been retained by the decedent.

(3) 3-YEAR RULE RETAINED FOR CERTAIN PURPOSES.—Paragraph (1) shall not apply for purposes of—

(A) section 303(b) (relating to distributions in redemption of stock to pay death taxes),

(B) section 2032A (relating to special valuation of certain farm, etc., real property), and

(C) subchapter C of chapter 64 (relating to lien for taxes).

(4) COORDINATION OF 3-YEAR RULE WITH section 6166(a)(1).—An estate shall be treated as meeting the 35-percent of adjusted gross estate requirement of section 6166(a)(1) only if the estate meets such requirement both with and without the application of paragraph (1).

The above amendment applies to the estates of decedents dying after the date of the enactment of this Act.

[¶ 5431] CODE SEC. 2053. EXPENSES, INDEBTEDNESS, AND TAXES.

* * *

(c) LIMITATIONS.—

(1) LIMITATIONS APPLICABLE TO SUBSECTIONS (a) AND (b).—

* * *

(B) CERTAIN TAXES.—Any income taxes on income received after the death of the decedent, or property taxes not accrued before his death, or any estate, succession, legacy, or inheritance taxes, shall not be deductible under this section.

* * *

(D) SECTION 6166 INTEREST.—No deduction shall be allowed under this section for any interest payable under section 6601 on any unpaid portion of the tax imposed by section 2001 for the period during which an extension of time for payment of such tax is in effect under section 6166.

* * *

[CCH Explanation at ¶ 227 and 714. Committee Reports at ¶ 10,380 and 11,465.]

Amendment Notes

Act Sec. 503(b)(1) amended Code Sec. 2053(c)(1) by adding a new subparagraph (D) to read as above.

The above amendment generally applies to estates of decedents dying after December 31, 1997. For a special rule, see Act Sec. 503(d)(2), below.

Act. Sec. 503(d)(2) provides:

(2) ELECTION.—In the case of the estate of any decedent dying before January 1, 1998, with respect to which there is an election under section 6166 of the Internal Revenue Code of 1986, the executor of the estate may elect to have the amendments made by this section apply with respect to installments due after the effective date of the election; except that the 2-percent portion of such installments shall be equal to the amount which would be the 4-percent portion of such installments without regard to such election. Such an election shall be made before January 1, 1999 in the manner prescribed by the Secretary of the Treasury and, once made, is irrevocable.

Act Sec. 1073(b)(3) amended Code Sec. 2053(c)(1)(B) by striking the last sentence. Prior to being stricken, the last sentence of Code Sec. 2053(c)(1)(B) read as follows:

This subparagraph shall not apply to any increase in the tax imposed by this chapter by reason of section 4980A(d).

The above amendment applies to estates of decedents dying after December 31, 1996.

[¶ 5433] CODE SEC. 2055. TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES.

(a) IN GENERAL.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers—

(1) to or for the use of the United States, any State, any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the

publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office;

(3) to a trustee or trustees, or a fraternal society, order, or association operating under the lodge system, but only if such contributions or gifts are to be used by such trustee or trustees, or by such fraternal society, order, or association, exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, such trust, fraternal society, order, or association would not be disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and such trustee or trustees, or such fraternal society, order, or association, does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office;

(4) to or for the use of any veterans' organization incorporated by Act of Congress, or of its departments or local chapters or posts, no part of the net earnings of which inures to the benefit of any private shareholder or individual*; or*

(5) to an employee stock ownership plan if such transfer qualifies as a qualified gratuitous transfer of qualified employer securities within the meaning of section 664(g).

* * *

Amendment Notes

Act Sec. 1530(c)(7)(i)[A]-(iii)[C] amended Code Sec. 2055(a) by striking "or" at the end of paragraph (3), by striking the period at the end of paragraph (4) and inserting "; or", and by inserting after paragraph (4) a new paragraph (5) to read as above.

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of enactment of this Act.

(e) DISALLOWANCE OF DEDUCTIONS IN CERTAIN CASES.—

* * *

(3) REFORMATIONS TO COMPLY WITH PARAGRAPH (2).—

* * *

(G) STATUTE OF LIMITATIONS.—The period for assessing any deficiency of any tax attributable to the application of this paragraph shall not expire before the date 1 year after the date on which the Secretary is notified that such reformation *(or other proceeding pursuant to subparagraph (J)*[*)*] has occurred.

* * *

(J) VOID OR REFORMED TRUST IN CASES OF INSUFFICIENT REMAINDER INTERESTS.—In the case of a trust that would qualify (or could be reformed to qualify pursuant to subparagraph (B)) but for failure to satisfy the requirement of paragraph (1)(D) or (2)(D) of section 664(d), such trust may be—

(i) declared null and void ab initio, or

(ii) changed by reformation, amendment, or otherwise to meet such requirement by reducing the payout rate or the duration (or both) of any noncharitable beneficiary's interest to the extent necessary to satisfy such requirement,

pursuant to a proceeding that is commenced within the period required in subparagraph (C)(iii). In a case described in clause (i), no deduction shall be allowed under this title for any transfer to the trust and any transactions entered into by the trust prior to being declared void shall be treated as entered into by the transferor.

* * *

[CCH Explanation at ¶ 281 and 284. Committee Reports at ¶ 11,555 and 13,435.]

Amendment Notes

Act Sec. 1089(b)(3) amended Code Sec. 2055(e)(3) by adding at the end a new subparagraph (J) to read as above.

Act Sec. 1089(b)(5) amended Code Sec. 2055(e)(3)(G) by inserting "(or other proceeding pursuant to subparagraph (J)[)]" after "reformation".

The above amendments apply to transfers in trust after July 28, 1997. For a special rule, see Act Sec. 1089(b)(6)(B), below.

Act Sec. 1089(b)(6)(B) provides:

(B) SPECIAL RULES FOR CERTAIN DECEDENTS.—The amendments made by this subsection shall not apply to transfers in trust under the terms of a will (or other testamentary instrument) executed on or before July 28, 1997, if the decedent—

(i) dies before January 1, 1999, without having republished the will (or amended such instrument) by codicil or otherwise, or

(ii) was on July 28, 1997, under a mental disability to change the disposition of his property and did not regain his competence to dispose of such property before the date of his death.

[¶ 5435] CODE SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE.

* * *

(b) LIMITATION IN THE CASE OF LIFE ESTATE OR OTHER TERMINABLE INTEREST.—

* * *

(7) ELECTION WITH RESPECT TO LIFE ESTATE FOR SURVIVING SPOUSE.—

* * *

(C) TREATMENT OF SURVIVOR ANNUITIES.—In the case of an annuity included in the gross estate of the decedent under section 2039 *(or, in the case of an interest in an annuity arising under the community property laws of a State, included in the gross estate of the decedent under section 2033)* where only the surviving spouse has the right to receive payments before the death of such surviving spouse—

(i) the interest of such surviving spouse shall be treated as a qualifying income interest for life, and

(ii) the executor shall be treated as having made an election under this subsection with respect to such annuity unless the executor otherwise elects on the return of tax imposed by section 2001.

An election under clause (ii), once made, shall be irrevocable.

(8) SPECIAL RULE FOR CHARITABLE REMAINDER TRUSTS.—

(A) IN GENERAL.—If the surviving spouse of the decedent is the only beneficiary of a qualified charitable remainder trust who is not a charitable beneficiary nor an ESOP beneficiary, paragraph (1) shall not apply to any interest in such trust which passes or has passed from the decedent to such surviving spouse.

(B) DEFINITIONS.—For purposes of subparagraph (A)—

(i) CHARITABLE BENEFICIARY.—The term "charitable beneficiary" means any beneficiary which is an organization described in section 170(c).

(ii) ESOP BENEFICIARY.—The term "ESOP beneficiary" means any beneficiary which is an employee stock ownership plan (as defined in section 4975(e)(7)) that holds a remainder interest in qualified employer securities (as defined in section 664(g)(4)) to be transferred to such plan in a qualified gratuitous transfer (as defined in section 664(g)(1)).

(iii) QUALIFIED CHARITABLE REMAINDER TRUST.—The term "qualified charitable remainder trust" means a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664).

* * *

[CCH Explanation at ¶ 239 and 284. Committee Reports at ¶ 12,665 and 13,435.]

Amendment Notes

Act Sec. 1311(a) amended Code Sec. 2056(b)(7)(C) by inserting "(or, in the case of an interest in an annuity arising under the community property laws of a State, included in the gross estate of the decedent under section 2033)" after "section 2039".

The above amendment applies to estates of decedents dying after the date of enactment of this Act.

Act Sec. 1530(c)(8) amended Code Sec. 2056(b)(8) to read as above. Prior to amendment, Code Sec. 2056(b)(8) read as follows:

(8) SPECIAL RULE FOR CHARITABLE REMAINDER TRUSTS.—

(A) IN GENERAL.—If the surviving spouse of the decedent is the only noncharitable beneficiary of a qualified charitable remainder trust, paragraph (1) shall not apply to any interest in such trust which passes or has passed from the decedent to such surviving spouse.

(B) DEFINITIONS.—For purposes of subparagraph (A)—

(i) NONCHARITABLE BENEFICIARY.—The term "noncharitable beneficiary" means any beneficiary of the qualified charitable remainder trust other than an organization described in section 170(c).

(ii) QUALIFIED CHARITABLE REMAINDER TRUST.—The term "qualified charitable remainder trust" means a charitable remainder annuity trust or charitable remainder unitrust (described in section 664)."

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of enactment of this Act.

[¶ 5437] CODE SEC. 2056A. QUALIFIED DOMESTIC TRUST.

(a) QUALIFIED DOMESTIC TRUST DEFINED.—For purposes of this section and section 2056(d), the term "qualified domestic trust" means, with respect to any decedent, any trust if—

(1) the trust instrument—

(A) *except as provided in regulations prescribed by the Secretary,* requires that at least 1 trustee of the trust be an individual citizen of the United States or a domestic corporation, and

(B) provides that no distribution (other than a distribution of income) may be made from the trust unless a trustee who is an individual citizen of the United States or domestic corporation has the right to withhold from such distribution the tax imposed by this section on such distribution,

(2) such trust meets such requirements as the Secretary may by regulations prescribe to ensure the collection of any tax imposed by subsection (b), and

(3) an election under this section by the executor of the decedent applies to such trust.

* * *

Amendment Notes

Act. Sec. 1303 provides:

SEC. 1303. TRANSITIONAL RULE UNDER SECTION 2056A.

(a) GENERAL RULE.—In the case of any trust created under an instrument executed before the date of the enactment of the Revenue Reconciliation Act of 1990, such trust shall be treated as meeting the requirements of paragraph (1) of section 2056A(a) of the Internal Revenue Code of 1986 if the trust instrument requires that all trustees of the trust be individual citizens of the United States or domestic corporations.

(b) EFFECTIVE DATE.—The provisions of subsection (a) shall take effect as if included in the provisions of section 11702(g) of the Revenue Reconciliation Act of 1990.

Act Sec. 1314(a) amended Code Sec. 2056A(a)(1)(A) by inserting "except as provided in regulations prescribed by the Secretary," before "requires".

The above amendment applies to estates of decedents dying after the date of enactment of this Act.

(c) DEFINITIONS.—For purposes of this section—

* * *

(3) TRUST.—To the extent provided in regulations prescribed by the Secretary, the term "trust" includes other arrangements which have substantially the same effect as a trust.

* * *

[CCH Explanation at ¶ 233, 235 and 237. Committee Reports at ¶ 12,625, 12,670 and 12,680.]

Amendment Notes

Act Sec. 1312(a) amended Code Sec. 2056A(c) by adding at the end a new paragraph (3) to read as above.

The above amendment applies to estates of decedents dying after the date of enactment of this Act.

[¶ 5439] CODE SEC. 2102. CREDITS AGAINST TAX.

* * *

(c) UNIFIED CREDIT.—

* * *

(3) SPECIAL RULES.—

(A) COORDINATION WITH TREATIES.—To the extent required under any treaty obligation of the United States, the credit allowed under this subsection shall be equal to the amount which bears the same ratio to *the applicable credit amount in effect under section 2010(c) for the calendar year which includes the date of death* as the value of the part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated. For purposes of the preceding sentence, property shall not be treated as situated in the United States if such property is exempt from the tax imposed by this subchapter under any treaty obligation of the United States.

* * *

[CCH Explanation at ¶ 201. Committee Reports at ¶ 10,365.]

Amendment Notes

Act Sec. 501(a)(1)(E) amended Code Sec. 2102(c)(3)(A) by striking "$192,800" and inserting "the applicable credit amount in effect under section 2010(c) for the calendar year which includes the date of death".

The above amendment applies to the estates of decedents dying, and gifts made, after December 31, 1997.

[¶ 5441] CODE SEC. 2105. PROPERTY WITHOUT THE UNITED STATES.

* * *

(b) BANK DEPOSITS AND CERTAIN OTHER DEBT OBLIGATIONS.—For purposes of this subchapter, the following shall not be deemed property within the United States.—

(1) amounts described in section 871(i)(3), if any interest thereon would not be subject to tax by reason of section 871(i)(1) were such interest received by the decedent at the time of his death,

(2) deposits with a foreign branch of domestic corporation or domestic partnership, if such branch is engaged in the commercial banking business,

(3) debt obligations, if, without regard to whether a statement meeting the requirements of section 871(h)(5) has been received, any interest thereon would be eligible for the exemption from tax under section 871(h)(1) were such interest received by the decedent at the time of his death, *and*

(4) obligations which would be original issue discount obligations as defined in section 871(g)(1) but for subparagraph (B)(i) thereof, if any interest thereon (were such interest received by the decedent at the time of his death) would not be effectively connected with the conduct of a trade or business within the United States.

Notwithstanding the preceding sentence, if any portion of the interest on an obligation referred to in paragraph (3) would not be eligible for the exemption referred to in paragraph (3) by reason of section 871(h)(4) if the interest were received by the decedent at the time of his death, then an appropriate portion (as determined in a manner prescribed by the Secretary) of the value (as determined for purposes of this chapter) of such debt obligation shall be deemed property within the United States.

* * *

[CCH Explanation at ¶ 212. Committee Reports at ¶ 12,630.]

Amendment Notes

Act Sec. 1304(a) amended Code Sec. 2105(b) by striking "and" at the end of paragraph (2), by striking the period at the end of paragraph (3) and inserting ", and", and by inserting after paragraph (3) a new paragraph (4) to read as above.

The above amendment applies to estates of decedents dying after the date of the enactment of this Act.

[¶ 5443] CODE SEC. 2107. EXPATRIATION TO AVOID TAX.

* * *

(c) CREDITS.—

* * *

(2) CREDIT FOR FOREIGN DEATH TAXES.—

* * *

(B) LIMITATION ON CREDIT.—The credit allowed by subparagraph (A) for such taxes paid to a foreign country shall not exceed the lesser of—

(i) the amount which bears the same ratio to the amount of such taxes actually paid to *such foreign country as the value of the property subjected to such taxes by such foreign country and* included in the gross estate solely by reason of subsection (b) bears to the value of all property subjected to such taxes by such foreign country, or

(ii) such property's proportionate share of the excess of—

(I) the tax imposed by subsection (a), over

(II) the tax which would be imposed by section 2101 but for this section.

(C) PROPORTIONATE SHARE.—In the case of property which is included in the gross estate solely by reason of subsection (b), such property's proportionate share is the percentage which the value of such property bears to the total value of all property included in the gross estate solely by reason of subsection (b).

* * *

[CCH Explanation at ¶ 930. Committee Reports at ¶ 13,895.]

Amendment Notes

Act Sec. 1602(g)(6)(A) amended Code Sec. 2107(c)(2)(B)(i) by striking "such foreign country in respect of property included in the gross estate as the value of the property" and inserting "such foreign country as the value of the property subjected to such taxes by such foreign country and".

Act Sec. 1602(g)(6)(B) amended Code Sec. 2107(c)(2)(C) to read as above. Prior to amendment, Code Sec. 2107(c)(2)(C) read as follows:

(C) PROPORTIONATE SHARE.—For purposes of subparagraph (B), a property's proportionate share is the percentage of the value of the property which is included in the gross estate solely by reason of subsection (b) bears to the total value of the gross estate.

The above amendments are effective as if included in the provisions of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which such amendments relate [generally effective for individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995.—CCH.].

[¶ 5445] CODE SEC. 2207A. RIGHT OF RECOVERY IN THE CASE OF CERTAIN MARITAL DEDUCTION PROPERTY.

(a) RECOVERY WITH RESPECT TO ESTATE TAX.—

* * *

(2) DECEDENT MAY OTHERWISE DIRECT.—Paragraph (1) shall not apply with respect to any property to the extent that the decedent in his will (or a revocable trust) specifically indicates an intent to waive any right of recovery under this subchapter with respect to such property.

* * *

[CCH Explanation at ¶ 243. Committee Reports at ¶ 12,620.]

Amendment Notes

Act Sec. 1302(a) amended Code Sec. 2207A(a)(2) to read as above. Prior to amendment, Code Sec. 2207A(a)(2) read as follows:

(2) DECEDENT MAY OTHERWISE DIRECT BY WILL.—Paragraph (1) shall not apply if the decedent otherwise directs by will.

The above amendment applies with respect to the estates of decedents dying after the date of the enactment of this Act.

[¶ 5447] CODE SEC. 2207B. RIGHT OF RECOVERY WHERE DECEDENT RETAINED INTEREST.

(a) ESTATE TAX.—

* * *

(2) DECEDENT MAY OTHERWISE DIRECT.—Paragraph (1) shall not apply with respect to any property to the extent that the decedent in his will (or a revocable trust) specifically indicates an intent to waive any right of recovery under this subchapter with respect to such property.

* * *

[CCH Explanation at ¶ 243. Committee Reports at ¶ 12,620.]

Amendment Notes

Act Sec. 1302(b) amended Code Sec. 2207B(a)(2) to read as above. Prior to amendment, Code Sec. 2207B(a)(2) read as follows:

(2) DECEDENT MAY OTHERWISE DIRECT BY WILL.—Paragraph (1) shall not apply if the decedent otherwise directs in a provision of his will (or a revocable trust) specifically referring to this section.

The above amendment applies with respect to the estates of decedents dying after the date of the enactment of this Act.

[¶ 5449] CODE SEC. 2501. IMPOSITION OF TAX.

(a) TAXABLE TRANSFERS.—

* * *

(3) EXCEPTION.—

* * *

(C) EXCEPTION FOR CERTAIN INDIVIDUALS.—Subparagraph (B) shall not apply to a *donor* meeting the requirements of section 877(c)(1).

* * *

Amendment Notes

Act Sec. 1602(g)(5) amended Code Sec. 2501(a)(3)(C) by striking "decedent" and inserting "donor".

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which such amendment relates [generally effective for individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995.—CCH.].

[¶ 5451] CODE SEC. 2503. TAXABLE GIFTS.

* * *

(b) *EXCLUSIONS FROM GIFTS.*—

(1) IN GENERAL.—In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year, the first $10,000 of such gifts to such person shall not, for purposes of subsection (a), be included in the total amount of gifts made during such year. Where there has been a transfer to any person of a present interest in property, the possibility that such interest may be diminished by the exercise of a power shall be disregarded in applying this subsection, if no part of such interest will at any time pass to any other person.

(2) INFLATION ADJUSTMENT.—In the case of gifts made in a calendar year after 1998, the $10,000 amount contained in paragraph (1) shall be increased by an amount equal to—

(A) $10,000, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 1997" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $1,000, such amount shall be rounded to the next lowest multiple of $1,000.

* * *

[CCH Explanation at ¶ 204. Committee Reports at ¶ 10,370.]

Amendment Notes

Act Sec. 501(c)(1)-(3) amended Code Sec. 2503(b) by striking the subsection heading and inserting "(b) EXCLUSIONS FROM GIFTS.—(1) IN GENERAL.—", by moving the text 2 ems to the right, and by adding a new paragraph (2) to read as above. Prior to amendment, the heading for Code Sec. 2503(b) read as follows:

(b) EXCLUSIONS FROM GIFTS.—

The above amendment applies to the estates of decedents dying, and gifts made, after December 31, 1997.

[¶ 5453] CODE SEC. 2504. TAXABLE GIFTS FOR PRECEDING CALENDAR PERIODS.

* * *

(c) VALUATION OF CERTAIN GIFTS FOR PRECEDING CALENDAR PERIODS.—If the time has expired within which a tax may be assessed under this chapter or under corresponding provisions of prior laws on the transfer of property by gift made during a preceding calendar period, as defined in section 2502(b), the value of such gift made in such preceding calendar period shall, for purposes of computing the tax under this chapter for any calendar year, be the value of such gift which was used in computing the tax for the last preceding calendar period for which a tax under this chapter or under corresponding provisions of prior laws was assessed or paid.

* * *

[CCH Explanation at ¶ 255. Committee Reports at ¶ 10,395.]

Amendment Notes

Act Sec. 506(d) amended Code Sec. 2504(c) by striking ", and if a tax under this chapter or under corresponding provisions of prior laws has been assessed or paid for such preceding calendar period" after "section 2502(b)".

The above amendment is effective on the date of enactment of this Act.

[¶ 5455] CODE SEC. 2505. UNIFIED CREDIT AGAINST GIFT TAX.

(a) GENERAL RULE.—In the case of a citizen or resident of the United States, there shall be allowed as a credit against the tax imposed by section 2501 for each calendar year an amount equal to—

(1) *the applicable credit amount in effect under section 2010(c) for such calendar year*, reduced by

(2) the sum of the amounts allowable as a credit to the individual under this section for all preceding calendar periods.

* * *

[CCH Explanation at ¶ 201. Committee Reports at ¶ 10,365.]

Amendment Notes

Act Sec. 501(a)(2) amended Code Sec. 2505(a)(1) by striking "$192,800" and inserting "the applicable credit amount in effect under section 2010(c) for such calendar year".

The above amendment applies to the estates of decedents dying, and gifts made, after December 31, 1997.

[¶ 5457] CODE SEC. 2523. GIFT TO SPOUSE.

* * *

(g) SPECIAL RULE FOR CHARITABLE REMAINDER TRUSTS.—

(1) IN GENERAL.—If, after the transfer, the donee spouse is the only non-charitable beneficiary (other than the donor) of a *qualified charitable remainder trust*, subsection (b) shall not apply to the interest in such trust which is transferred to the donee spouse.

* * *

Amendment Notes

Act Sec. 1604(g)(4) amended Code Sec. 2523(g)(1) by striking "qualified remainder trust" and inserting "qualified charitable remainder trust".

The above amendment is effective on the date of the enactment of this Act.

[¶ 5459] CODE SEC. 2612. TAXABLE TERMINATION; TAXABLE DISTRIBUTION; DIRECT SKIP.

* * *

(c) DIRECT SKIP.—For purposes of this chapter—

* * *

(2) Look-thru rules not to apply.—Solely for purposes of determining whether any transfer to a trust is a direct skip, the rules of *section 2651(f)(2)* shall not apply.

* * *

[CCH Explanation at ¶ 249. Committee Reports at ¶ 10,425.]

Amendment Notes

Act Sec. 511(b)(1) amended Code Sec. 2612(c) by striking paragraph (2) and by redesignating paragraph (3) as paragraph (2). Prior to being stricken, Code Sec. 2612(c)(2) read as follows:

(2) SPECIAL RULE FOR TRANSFERS TO GRANDCHILDREN.—For purposes of determining whether any transfer is a direct skip, if—

(A) an individual is a grandchild of the transferor (or the transferor's spouse or former spouse), and

(B) as of the time of the transfer, the parent of such individual who is a lineal descendant of the transferor (or the transferor's spouse or former spouse) is dead,

such individual shall be treated as if such individual were a child of the transferor and all of that grandchild's children shall be treated as if they were grandchildren of the transferor. In the case of lineal descendants below a grandchild, the preceding sentence may be reapplied. If any transfer of property to a trust would be a direct skip but for this paragraph, any generation assignment under this paragraph shall apply also for purposes of applying this chapter to transfers from the portion of the trust attributable to such property.

Act Sec. 511(b)(2) amended Code Sec. 2612(c)(2), as redesignated by Act Sec. 511(b)(1), by striking "section 2651(e)(2)" and inserting "section 2651(f)(2)".

The above amendments apply to terminations, distributions, and transfers occurring after December 31, 1997.

[¶ 5461] CODE SEC. 2631. GST EXEMPTION.

* * *

(c) Inflation Adjustment.—In the case of an individual who dies in any calendar year after 1998, the $1,000,000 amount contained in subsection (a) shall be increased by an amount equal to—

(1) $1,000,000, multiplied by

(2) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 1997" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the next lowest multiple of $10,000.

* * *

[CCH Explanation at ¶ 204. Committee Reports at ¶ 10,370.]

Amendment Notes

Act Sec. 501(d) amended Code Sec. 2631 by adding a new subsection (c) to read as above.

The above amendment applies to the estates of decedents dying, and gifts made, after December 31, 1997.

[¶ 5463] CODE SEC. 2651. GENERATION ASSIGNMENT.

* * *

(e) Special Rule for Persons With a Deceased Parent.—

(1) In general.—For purposes of determining whether any transfer is a generation-skipping transfer, if—

(A) an individual is a descendant of a parent of the transferor (or the transferor's spouse or former spouse), and

(B) such individual's parent who is a lineal descendant of the parent of the transferor (or the transferor's spouse or former spouse) is dead at the time the transfer (from which an interest of such individual is established or derived) is subject to a tax imposed by chapter 11 or 12 upon the transferor (and if there shall be more than 1 such time, then at the earliest such time),

such individual shall be treated as if such individual were a member of the generation which is 1 generation below the lower of the transferor's generation or the generation assignment of the youngest living ancestor of such individual who is also a descendant of the parent of the transferor (or the transferor's spouse or former spouse), and the generation assignment of any descendant of such individual shall be adjusted accordingly.

(2) Limited application of subsection to collateral heirs.—This subsection shall not apply with respect to a transfer to any individual who is not a lineal descendant of the transferor (or the transferor's spouse or former spouse) if, at the time of the transfer, such transferor has any living lineal descendant.

Amendment Notes

Act Sec. 511(a) amended Code Sec. 2651 by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) a new subsection (e) to read as above.

The above amendment applies to terminations, distributions, and transfers occurring after December 31, 1997.

(f) OTHER SPECIAL RULES.—

* * *

[CCH Explanation at ¶ 249. Committee Reports at ¶ 10,425.]

Amendment Notes

Act Sec. 511(a) amended Code Sec. 2651 by redesignating subsection (e) as subsection (f).

The above amendment applies to terminations, distributions, and transfers occurring after December 31, 1997.

[¶ 5465] CODE SEC. 2652. OTHER DEFINITIONS.

* * *

(b) TRUST AND TRUSTEE.—

(1) TRUST.—The term "trust" includes any arrangement (other than an estate) which, although not a trust, has substantially the same effect as a trust. *Such term shall not include any trust during any period the trust is treated as part of an estate under section 646.*

* * *

[CCH Explanation at ¶ 261. Committee Reports at ¶ 12,635.]

Amendment Notes

Act Sec. 1305(b) amended Code Sec. 2652(b)(1) by adding at the end a new sentence to read as above.

The above amendment applies with respect to estates of decedents dying after the date of the enactment of this Act.

[¶ 5467] CODE SEC. 3301. RATE OF TAX.

There is hereby imposed on every employer (as defined in section 3306(a)) for each calendar year an excise tax, with respect to having individuals in his employ, equal to—

(1) 6.2 percent in the case of calendar years 1988 through *2007*; or

(2) 6.0 percent in the case of calendar year *2008* and each calendar year thereafter;

of the total wages (as defined in section 3306(b)) paid by him during the calendar year with respect to employment (as defined in section 3306(c)).

* * *

[CCH Explanation at ¶ 1120. Committee Reports at ¶ 11,315.]

Amendment Notes

Act Sec. 1035(1)-(2) amended Code Sec. 3301 by striking "1998" in paragraph (1) and inserting "2007", and by striking "1999" in paragraph (2) and inserting "2008".

The above amendment is effective on the date of the enactment of this Act.

[¶ 5468] CODE SEC. 3306. DEFINITIONS.

* * *

(c) EMPLOYMENT.—For purposes of this chapter, the term "employment" means any service performed prior to 1955, which was employment for purposes of subchapter C of chapter 9 of the Internal Revenue Code of 1939 under the law applicable to the period in which such service was performed, and (A) any service, of whatever nature, performed after 1954 by an employee for the person employing him, irrespective of the citizenship or residence of either, (i) within the United States, or (ii) on or in connection with an American vessel or American aircraft under a contract of service which is entered into within the United States or during the performance of which and while the employee is employed on the vessel or aircraft it touches at a port in the United States, if the employee is employed on and in connection with such vessel or aircraft when outside the United States, and (B) any service, of whatever nature, performed after 1971 outside the United States (except in a contiguous country with which the United States has an agreement relating to unemployment compensation) by a citizen of the United States as an employee of an American employer (as defined in subsection (j)(3)), except—

* * *

(19) service which is performed by a nonresident alien individual for the period he is temporarily present in the United States as a nonimmigrant under subparagraph (F), (J), (M), or (Q) of section 101(a)(15) of the Immigration and Nationality Act, as amended (8 U.S.C. 1101(a)(15)(F) or (J)), and which is performed to carry out the purpose specified in subparagraph (F), (J), (M), or (Q) as the case may be;

(20) service performed by a full time student (as defined in subsection (q)) in the employ of an organized camp—

(A) if such camp—

(i) did not operate for more than 7 months in the calendar year and did not operate for more than 7 months in the preceding calendar year, or

(ii) had average gross receipts for any 6 months in the preceding calendar year which were not more than 33⅓ percent of its average gross receipts for the other 6 months in the preceding calendar year; and

(B) if such full time student performed services in the employ of such camp for less than 13 calendar weeks in such calendar year*; or*

(21) service performed by a person committed to a penal institution.

* * *

[CCH Explanation at ¶ 1126. Committee Reports at ¶ 20,065.]

Amendment Notes

Balanced Budget Act

Act Sec. 5406(a)(1)-(3) amended Code Sec. 3306(c) by striking "or" at the end of paragrah (19), by striking the period at the end of paragraph (20) and inserting "; or", and by adding at the end a new paragraph (21) to read as above.

The above amendment applies with respect to service performed after January 1, 1994.

[¶ 5468B] CODE SEC. 3309. STATE LAW COVERAGE OF SERVICES PERFORMED FOR NONPROFIT ORGANIZATIONS OR GOVERNMENTAL ENTITIES.

* * *

(b) SECTION NOT TO APPLY TO CERTAIN SERVICE.—This section shall not apply to service performed—

(1) in the employ of (A) a church or convention or association of churches, (B) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches, *or (C) an elementary or secondary school which is operated primarily for religious purposes, which is described in section 501(c)(3), and which is exempt from tax under section 501(a)*;

(2) by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order;

(3) in the employ of a governmental entity referred to in paragraph (7) of section 3306(c), if such service is performed by an individual in the exercise of his duties—

(A) as an elected official;

(B) as a member of a legislative body, or a member of the judiciary, of a State or political subdivision thereof;

(C) as a member of the State National Guard or Air National Guard;

(D) as an employee serving on a temporary basis in case of fire, storm, snow, earthquake, flood, or similar emergency;

(E) in a position which, under or pursuant to the State law, is designated as (i) a major nontenured policymaking or advisory position, or (ii) a policymaking or advisory position the performance of the duties of which ordinarily does not require more than 8 hours per week; *or*

(F) as an election official or election worker if the amount of remuneration received by the individual during the calendar year for services as an election official or election worker is less than $1,000;

(4) in a facility conducted for the purpose of carrying out a program of—

(A) rehabilitation for individuals whose earnings capacity is impaired by age or physical or mental deficiency or injury, or

(B) providing remunerative work for individuals who because of their impaired physical or mental capacity cannot be readily absorbed in the competitive labor market,

by an individual receiving such rehabilitation or remunerative work;

(5) as part of an unemployment work-relief or work-training program assisted or financed in whole or in part by any Federal agency or an agency of a State or political subdivision thereof, by an individual receiving such work relief or work training; and

(6) by an inmate of a custodial or penal institution.

* * *

[CCH Explanation at ¶ 1123 and 1129. Committee Reports at ¶ 20,055 and 20,075.]

Amendment Notes

Balanced Budget Act

Act Sec. 5405(a)(1)-(3) amended Code Sec. 3309(b)(3) by striking "or" at the end of subparagraph (D), by adding "or" at the end of subparagraph (E), and by inserting after subparagraph (E) a new subparagraph (F) to read as above.

Act Sec. 5407(a)(1)-(2) amended Code Sec. 3309(b)(1) by striking "or" at the end of subparagraph (A), and by inserting before the semicolon at the end ", or (C) an elementary or secondary school which is operated primarily for religious purposes, which is described in section 501(c)(3), and which is exempt from tax under section 501(a)".

The above amendments apply with respect to service performed after the date of the enactment of this Act.

[¶ 5469] CODE SEC. 4001. IMPOSITION OF TAX.

(a) IMPOSITION OF TAX.—

(1) IN GENERAL.—There is hereby imposed on the 1st retail sale of any passenger vehicle a tax equal to 10 percent of the price for which so sold to the extent such price exceeds the applicable amount.

(2) APPLICABLE AMOUNT.—

(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), the applicable amount is $30,000.

(B) QUALIFIED CLEAN-FUEL VEHICLE PROPERTY.—In the case of a passenger vehicle which is propelled by a fuel which is not a clean-burning fuel and to which is installed qualified clean-fuel vehicle property (as defined in section 179A(c)(1)(A)) for purposes of permitting such vehicle to be propelled by a clean-burning fuel, the applicable amount is equal to the sum of—

(i) the dollar amount in effect under subparagraph (A), plus

(ii) the increase in the price for which the passenger vehicle was sold (within the meaning of section 4002) due to the installation of such property.

(C) PURPOSE BUILT PASSENGER VEHICLE.—

(i) IN GENERAL.—In the case of a purpose built passenger vehicle, the applicable amount is equal to 150 percent of the dollar amount in effect under subparagraph (A).

(ii) PURPOSE BUILT PASSENGER VEHICLE.—For purposes of clause (i), the term "purpose built passenger vehicle" means a passenger vehicle produced by an original equipment manufacturer and designed so that the vehicle may be propelled primarily by electricity.

* * *

Amendment Notes

Act Sec. 906(a) amended Code Sec. 4001(a) to read as above. Prior to amendment, Code Sec. 4001(a) read as follows:

(a) IMPOSITION OF TAX.—There is hereby imposed on the 1st retail sale of any passenger vehicle a tax equal to 10 percent of the price for which so sold to the extent such price exceeds $30,000.

The above amendment applies to sales and installations occurring after the date of the enactment of this Act.

(e) INFLATION ADJUSTMENT.—

(1) IN GENERAL.—The $30,000 amount in subsection (a) shall be increased by an amount equal to—

(A) $30,000, multiplied by

(B) the cost-of-living adjustment under section 1(f)(3) for the calendar year in which the vehicle is sold, determined by substituting "calendar year 1990" for "calendar year 1992" in subparagraph (B) thereof.

* * *

Amendment Notes

Act Sec. 906(b)(1) amended Code Sec. 4001(e) by striking "and section 4003(a)" after "in subsection (a)".

The above amendment applies to sales and installations occurring after the date of the enactment of this Act.

(f) PHASEDOWN.—For sales occurring in calendar years after 1995 and before 2003, *subsection (a)(1) and section 4003(a)* shall be applied by substituting for "10 percent", *each place it appears,* the percentage determined in accordance with the following table:

If the calendar year is:	*The percentage is:*
1996	9 percent
1997	8 percent
1998	7 percent
1999	6 percent

2000	5 percent
2001	4 percent
2002	3 percent

Amendment Notes

Act Sec. 906(b)(2) amended Code Sec. 4001(f) by striking "subsection (a)" and inserting "subsection (a)(1)".

The above amendment applies to sales and installations occurring after the date of the enactment of this Act.

Act Sec. 1601(f)(3)(A)(i)-(ii) amended Code Sec. 4001(f) by inserting "and section 4003(a)" after "subsection (a)", and by inserting ", each place it appears," before "the percentage".

The above amendment applies to sales after the date of the enactment of this Act.

(g) TERMINATION.—The *taxes imposed by this section and section 4003* shall not apply to any sale, *use, or installation* after December 31, 2002.

* * *

[CCH Explanation at ¶ 1242 and 1247. Committee Reports at ¶ 10,540 and 13,655.]

Amendment Notes

Act Sec. 1601(f)(3)(B) amended Code Sec. 4001(g) by striking "tax imposed by this section" and inserting "taxes imposed by this section and section 4003" and by striking "or use" and inserting ", use, or installation".

The above amendment applies to sales after the date of the enactment of this Act.

[¶ 5471] CODE SEC. 4003. SPECIAL RULES.

(a) SEPARATE PURCHASE OF VEHICLE AND PARTS AND ACCESSORIES THEREFOR.—Under regulations prescribed by the Secretary—

(1) IN GENERAL.—Except as provided in paragraph (2), if—

(A) the owner, lessee, or operator of any passenger vehicle installs (or causes to be installed) any part or accessory *(other than property described in section 4001(a)(2)(B))* on such vehicle, and

(B) such installation is not later than the date 6 months after the date the vehicle was 1st placed in service,

then there is hereby imposed on such installation a tax equal to 10 percent of the price of such part or accessory and its installation.

(2) LIMITATION.—The tax imposed by paragraph (1) on the installation of any part or accessory shall not exceed 10 percent of the excess (if any) of—

(A) the sum of—

(i) the price of such part or accessory and its installation,

(ii) the aggregate price of the parts and accessories (and their installation) installed before such part or accessory, plus

(iii) the price for which the passenger vehicle was sold, over

(B) the appropriate applicable amount as determined under section 4001(a)(2).

(3) EXCEPTIONS.—Paragraph (1) shall not apply if—

(A) the part or accessory installed is a replacement part or accessory,

(B) the part or accessory is installed to enable or assist an individual with a disability to operate the vehicle, or to enter or exit the vehicle, by compensating for the effect of such disability, or

(C) the aggregate price of the parts and accessories (and their installation) described in paragraph (1) with respect to the vehicle does not exceed *$1,000* (or such other amount or amounts as the Secretary may by regulation prescribe).

The price of any part or accessory (and its installation) to which paragraph (1) does not apply by reason of this paragraph shall not be taken into account under paragraph (2)(A).

* * *

[CCH Explanation at ¶ 1245 and 1247. Committee Reports at ¶ 10,540 and 12,715.]

Amendment Notes

Act Sec. 906(b)(3) amended Code Sec. 4003(a)(1)(A) by inserting "(other than property described in section 4001(a)(2)(B))" after "part or accessory".

Act Sec. 906(b)(4) amended Code Sec. 4003(a)(2)(B) to read as above. Prior to amendment, Code Sec. 4003(a)(2)(B) read as follows:

(B) $30,000.

The above amendments apply to sales and installations occurring after the date of the enactment of this Act.

Act Sec. 1401(a) amended Code Sec. 4003(a)(3)(C) by striking "$200" and inserting "$1,000".

The above amendment applies to installations on vehicles sold after the date of the enactment of this Act.

[¶ 5473] CODE SEC. 4041. IMPOSITION OF TAX.

(a) DIESEL FUEL AND SPECIAL MOTOR FUELS.—

(1) TAX ON DIESEL FUEL IN CERTAIN CASES.—

(A) IN GENERAL.—There is hereby imposed a tax on any liquid other than gasoline (as defined in section 4083)—

(i) sold by any person to an owner, lessee, or other operator of a diesel-powered highway vehicle *or a diesel-powered train* for use as a fuel in such *vehicle or train*, or

(ii) used by any person as a fuel in a diesel-powered highway vehicle *or a diesel-powered train* unless there was a taxable sale of such fuel under clause (i).

* * *

(D) *[Stricken.]*

[Caution: Code Sec. 4041(a)(2), below, as amended by Act Sec. 907(a)(1) of the Taxpayer Relief Act of 1997 but prior to amendment by Act Sec. 1032(e)(1) of the Taxpayer Relief Act of 1997, is effective on October 1, 1997 and before July 1, 1998.—CCH.]

(2) SPECIAL MOTOR FUELS.—

(A) IN GENERAL.—There is hereby imposed a tax on any liquid (other than kerosene, gas oil, fuel oil, or any product taxable under section 4081)—

(i) sold by any person to an owner, lessee, or other operator of a motor vehicle or motorboat for use as a fuel in such motor vehicle or motorboat, or

(ii) used by any person as a fuel in a motor vehicle or motorboat unless there was a taxable sale of such liquid under clause (i).

(B) RATE OF TAX.—The rate of the tax imposed by this paragraph shall be—

(i) except as otherwise provided in this subparagraph, the rate of tax specified in section 4081(a)(2)(A)(i) which is in effect at the time of such sale or use,

(ii) 13.6 cents per gallon in the case of liquefied petroleum gas, and

(iii) 11.9 cents per gallon in the case of liquefied natural gas.

In the case of any sale or use after September 30, 1999, clause (ii) shall be applied by substituting "3.2 cents" for "13.6 cents", and clause (iii) shall be applied by substituting "2.8 cents" for "11.9 cents".

[Caution: Code Sec. 4041(a)(2), below, as amended by Act Secs. 907(a)(1) and 1032(e)(1) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.]

(2) SPECIAL MOTOR FUELS.—

(A) IN GENERAL.—There is hereby imposed a tax on any liquid (other than gas oil, fuel oil, or any product taxable under section 4081)—

(i) sold by any person to an owner, lessee, or other operator of a motor vehicle or motorboat for use as a fuel in such motor vehicle or motorboat, or

(ii) used by any person as a fuel in a motor vehicle or motorboat unless there was a taxable sale of such liquid under clause (i).

(B) RATE OF TAX.—The rate of the tax imposed by this paragraph shall be—

(i) except as otherwise provided in this subparagraph, the rate of tax specified in section 4081(a)(2)(A)(i) which is in effect at the time of such sale or use,

(ii) 13.6 cents per gallon in the case of liquefied petroleum gas, and

(iii) 11.9 cents per gallon in the case of liquefied natural gas.

In the case of any sale or use after September 30, 1999, clause (ii) shall be applied by substituting "3.2 cents" for "13.6 cents", and clause (iii) shall be applied by substituting "2.8 cents" for "11.9 cents".

* * *

Amendment Notes

Act Sec. 901(e) provides:

(e) DELAYED DEPOSITS OF HIGHWAY MOTOR FUEL TAX REVENUES.—Notwithstanding section 6302 of the Internal Revenue Code of 1986, in the case of deposits of taxes imposed by sections 4041 and 4081 (other than subsection (a)(2)(A)(ii)) of the Internal Revenue Code of 1986, the due date for any deposit which would (but for this subsection) be required to be made after July 31, 1998, and before October 1, 1998, shall be October 5, 1998.

Act Sec. 902(b)(1)(A)-(B) amended Code Sec. 4041(a)(1)(A) by striking ", a diesel-powered train, or a diesel-powered boat" each place it appears and inserting "or a diesel-powered train", and by striking "vehicle, train, or boat" and inserting "vehicle or train".

Act Sec. 902(b)(2) amended Code Sec. 4041(a)(1) by striking subparagraph (D). Prior to being stricken, Code Sec. 4041(a)(1)(D) read as follows:

(D) DIESEL FUEL USED IN MOTORBOATS.—In the case of any sale for use, or use, of fuel in a diesel-powered motorboat—

(i) no tax shall be imposed by subsection (a) or (d)(1) during the period beginning on the date which is 7 days after the date of the enactment of the Small Business Job Protection Act of 1996 and ending on December 31, 1997,

(ii) effective during the period after September 30, 1999, and before January 1, 2000, the rate of tax imposed by this paragraph is 24.3 cents per gallon, and

(iii) the termination of the tax under subsection (d) shall not occur before January 1, 2000.

The above amendments are effective on January 1, 1998.

Act Sec. 907(a)(1) amended Code Sec. 4041(a)(2) to read as above. Prior to amendment, Code Sec. 4041(a)(2) read as follows:

(2) SPECIAL MOTOR FUELS.—There is hereby imposed a tax on benzol, benzene, naphtha, liquefied petroleum gas, casing head and natural gasoline, or any other liquid (other than a Kerosene, gas oil, or fuel oil, or any product taxable under section 4081)—

(A) sold by any person to an owner, lessee, or other operator of a motor vehicle or motorboat for use as a fuel in such motor vehicle or motorboat, or

(B) used by any person as a fuel in a motor vehicle or motorboat unless there was a taxable sale of such liquid under subparagraph (A).

The rate of the tax imposed by this paragraph shall be the rate of tax specified in section 4081(a)(2)(A)(i) on gasoline which is in effect at the time of such sale or use.

The above amendment is effective on October 1, 1997.

Act Sec. 1032(e)(1) amended Code Sec. 4041(a)(2) by striking "kerosene" after "(other than".

The above amendment is effective on July 1, 1998.

Act Sec. 1601(f)(4)(B) amended Code Sec. 4041(a)(2) by striking "section 4081(a)(2)(A)" in the last sentence and inserting "section 4081(a)(2)(A)(i)".

The above amendment is generally effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective August 27, 1996.—CCH.].

(c) NONCOMMERCIAL AVIATION.—

[Caution: Code Sec. 4041(c)(1), below, as amended by Act Sec. 1032(e)(2) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.]

(1) TAX ON NONGASOLINE FUELS WHERE NO TAX IMPOSED ON FUEL UNDER SECTION 4091.—There is hereby imposed a tax upon *kerosene and any other liquid* (other than any product taxable under section 4081)—

(A) sold by any person to an owner, lessee, or other operator of an aircraft, for use as a fuel in such aircraft in noncommercial aviation; or

(B) used by any person as a fuel in an aircraft in noncommercial aviation, unless there was a taxable sale of such liquid under this section.

The rate of the tax imposed by this paragraph shall be the rate of tax specified in section 4091(b)(1) which is in effect at the time of such sale or use. No tax shall be imposed by this paragraph on the sale or use of *kerosene and any other liquid* if there was a taxable sale of such liquid under section 4091.

(2) DEFINITION OF NONCOMMERCIAL AVIATION.—For purposes of this chapter, the term "noncommercial aviation" means any use of an aircraft, other than use in a business of transporting persons or property for compensation or hire by air. The term also includes any use of an aircraft, in a business described in the preceding sentence, which is properly allocable to any transportation exempt from the taxes imposed by sections 4261 and 4271 by reason of section 4281 or 4282 *or by reason of section 4261(h).*

(3) TERMINATION.—The rate of the taxes imposed by paragraph (1) shall be 4.3 cents per gallon—

(A) after December 31, 1996, and before the date which is 7 days after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

(B) after *September 30, 2007.*

Amendment Notes

Act Sec. 1031(a)(3) amended Code Sec. 4041(c)(3)(B) by striking "September 30, 1997" and inserting "September 30, 2007".

The above amendment is effective on October 1, 1997.

Act Sec. 1032(e)(2) amended Code Sec. 4041(c)(1) by striking "any liquid" and inserting "kerosene and any other liquid".

The above amendment is effective on July 1, 1998.

Act Sec. 1435(b) amended Code Sec. 4041(c)(2) by inserting before the period "or by reason of section 4261(h)" in the last sentence.

The above amendment is effective October 1, 1997.

(d) ADDITIONAL TAXES TO FUND LEAKING UNDERGROUND STORAGE TANK TRUST FUND.—

(1) TAX ON SALES AND USES SUBJECT TO TAX UNDER SUBSECTION (a).—In addition to the taxes imposed by subsection (a), there is hereby imposed a tax of 0.1 cent a gallon on the sale or use of any liquid (other than liquefied petroleum gas *and other than liquefied natural gas*) if tax is imposed by subsection (a)(1) or (2) on such sale or use.

* * *

Amendment Notes

Act Sec. 907(a)(2) amended Code Sec. 4041(d)(1) by inserting "and other than liquefied natural gas" after "liquefied petroleum gas".

The above amendment is effective on October 1, 1997.

(l) EXEMPTION FOR CERTAIN USES.—No tax shall be imposed under this section on any liquid sold for use in, or used in, a helicopter *or a fixed-wing aircraft* for purposes of providing transportation with respect to which the requirements of subsection (e) or (f) of section 4261 are met.

Amendment Notes

Act Sec. 1601(f)(4)(A)(i)-(ii) amended Code Sec. 4041(l) by inserting "or a fixed-wing aircraft" after "helicopter", and by striking "HELICOPTER" in the heading before "USES".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective August 27, 1996.—CCH.].

(m) CERTAIN ALCOHOL FUELS.—

(1) IN GENERAL.—In the case of the sale or use of any partially exempt methanol or ethanol fuel—

(A) the rate of the tax imposed by subsection (a)(2) shall be—

(i) after September 30, 1997, and before October 1, 1999—

(I) in the case of fuel none of the alcohol in which consists of ethanol, 9.15 cents per gallon, and

(II) in any other case, 11.3 cents per gallon, and

(ii) after September 30, 1999—

(I) in the case of fuel none of the alcohol in which consists of ethanol, 2.15 cents per gallon, and

(II) in any other case, 4.3 cents per gallon, and

(B) the rate of the tax imposed by subsection (c)(1) shall be the comparable rate under section 4091(c)(1).

* * *

[CCH Explanation at ¶ 1201, 1206, 1209, 1211, 1216, 1221 and 1223. Committee Reports at ¶ 10,515, 10,520, 10,545, 11,275, 11,285, 12,870 and 13,660.]

Amendment Notes

Act Sec. 907(b) amended Code Sec. 4041(m)(1)(A) to read as above. Prior to amendment, Code Sec. 4041(m)(1)(A) read as follows:

(A) the rate of the tax imposed by subsection (a)(2) shall be—

(i) 11.3 cents per gallon after September 30, 1993, and before October 1, 1999, and

(ii) 4.3 cents per gallon after September 30, 1999, and

The above amendment is effective on October 1, 1997.

[¶ 5475] CODE SEC. 4051. IMPOSITION OF TAX ON HEAVY TRUCKS AND TRAILERS SOLD AT RETAIL.

* * *

(b) SEPARATE PURCHASE OF TRUCK OR TRAILER AND PARTS AND ACCESSORIES THEREFOR.—Under regulations prescribed by the Secretary—

* * *

(2) EXCEPTIONS.—Paragraph (1) shall not apply if—

(A) the part or accessory installed is a replacement part or accessory, or

(B) the aggregate price of the parts and accessories (and their installation) described in paragraph (1) with respect to any vehicle does not exceed *$1,000* (or such other amount or amounts as the Secretary may by regulations prescribe).

* * *

Amendment Notes

Act Sec. 1401(a) amended Code Sec. 4051(b)(2)(B) by striking "$200" and inserting "$1,000".

The above amendment applies to installations on vehicles sold after the date of the enactment of this Act.

(d) Credit Against Tax for Tire Tax.—If—

(1) tires are sold on or in connection with the sale of any article, and

(2) tax is imposed by this subchapter on the sale of such tires,

there shall be allowed as a credit against the tax imposed by this subchapter an amount equal to the tax (if any) imposed by section 4071 on such tires.

[CCH Explanation at ¶ 1239, 1245 and 1291. Committee Reports at ¶ 12,715, 12,725 and 12,850.]

Amendment Notes

Act Sec. 1402(a) amended Code Sec. 4051(e) to read as above. Prior to amendment, Code Sec. 4051(e) read as follows:

(e) Transitional Rule.—In the case of any article taxable under subsection (a) on which tax was imposed under section 4061(a), subsection (a) shall be applied by substituting "2 percent" for "12 percent".

The above amendment is effective January 1, 1998.

Act Sec. 1432(a) amended Code Sec. 4051 by striking subsection (d) and by redesignating subsection (e) as subsection (d). Prior to being stricken, Code Sec. 4051(d) read as follows:

(d) Temporary Reduction in Tax on Certain Piggyback Trailers.—

(1) In general.—In the case of piggyback trailers or semitrailers sold within the 1-year period beginning on July 18, 1984, subsection (a) shall be applied by substituting "6 percent" for "12 percent".

(2) Piggyback trailers or semitrailers.—For purposes of this subsection, the term "piggyback trailers or semitrailers" means any trailer or semitrailer—

(A) which is designed for use principally in connection with trailer-on-flatcar service by rail, and

(B)(i) both the seller and the purchaser of which are registered in a manner similar to registration under section 4222, and

(ii) with respect to which the purchaser certifies (at such time and in such form and manner as the Secretary prescribes by regulations) to the seller that such trailer or semitrailer—

(I) will be used, or resold for use, principally in connection with such service, or

(II) will be incorporated into an article which will be so used or resold.

(3) Additional tax where nonqualified use.—If any piggyback trailer or semitrailer was subject to tax under subsection (a) at the 6 percent rate and such trailer or semitrailer is used or resold for use other than for a use described in paragraph (2)—

(A) such use or resale shall be treated as a sale to which subsection (a) applies,

(B) the amount of the tax imposed under subsection (a) on such sale shall be equal to the amount of the tax which was imposed on the first retail sale, and

(C) the person so using or reselling such trailer or semitrailer shall be liable for the tax imposed by subsection (a).

No tax shall be imposed by reason of this paragraph on any use or resale which occurs more than 6 years after the date of the first retail sale.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5477] CODE SEC. 4052. DEFINITIONS AND SPECIAL RULES.

* * *

(b) Determination of Price.—

(1) In general.—In determining price for purposes of this subchapter—

(A) there shall be included any charge incident to placing the article in condition ready for use,

(B) there shall be excluded—

(i) the amount of the tax imposed by this subchapter,

(ii) if stated as a separate charge, the amount of any retail sales tax imposed by any State or political subdivision thereof or the District of Columbia, whether the liability for such tax is imposed on the vendor or vendee, *and*

(iii) the value of any component of such article if—

(I) such component is furnished by the first user of such article, and

(II) such component has been used before such furnishing, and

(C) the price shall be determined without regard to any trade-in.

* * *

Amendment Notes

Act Sec. 1402(b) amended Code Sec. 4052(b)(1)(B) by striking clause (iii), by adding "and" at the end of clause (ii),

and by redesignating clause (iv) as clause (iii). Prior to amendment, Code Sec. 4052(b)(1)(B)(iii) read as follows:

(iii) the fair market value (including any tax imposed by section 4071) at retail of any tires (not including any metal rim or rim base), and

The above amendment is effective on January 1, 1998.

(d) CERTAIN OTHER RULES MADE APPLICABLE.—Under regulations prescribed by the Secretary, rules similar to the *rules of subsections (c) and (d) of section 4216 (relating to partial payments) shall apply* for purposes of this subchapter.

Amendment Notes

Act Sec. 1434(b)(1) amended Code Sec. 4052(d) by striking "rules of—" and all that follows through "shall apply" and inserting "rules of subsections (c) and (d) of section 4216 (relating to partial payments) shall apply". Prior to amendment, Code Sec. 4052(d) read as follows:

(d) CERTAIN OTHER RULES MADE APPLICABLE.—Under regulations prescribed by the Secretary, rules similar to the rules of—

(1) subsections (c) and (d) of section 4216 (relating to partial payments), and

(2) section 4222 (relating to registration),

shall apply for purposes of this subchapter.

The above amendment is effective January 1, 1998.

(e) LONG-TERM LEASE.—For purposes of this section, the term "long-term lease" means any lease with a term of 1 year or more. In determining a lease term for purposes of the preceding sentence, the rules of section 168(i)(3)(A) shall apply.

Amendment Notes

Act Sec. 1434(a) amended Code Sec. 4052 by redesignating the subsection defining a long-term lease as subsection (e).

The above amendment is effective January 1, 1998.

(f) CERTAIN REPAIRS AND MODIFICATIONS NOT TREATED AS MANUFACTURE.—

(1) IN GENERAL.—An article described in section 4051(a)(1) shall not be treated as manufactured or produced solely by reason of repairs or modifications to the article (including any modification which changes the transportation function of the article or restores a wrecked article to a functional condition) if the cost of such repairs and modifications does not exceed 75 percent of the retail price of a comparable new article.

(2) EXCEPTION.—Paragraph (1) shall not apply if the article (as repaired or modified) would, if new, be taxable under section 4051 and the article when new was not taxable under this section or the corresponding provision of prior law.

Amendment Notes

Act Sec. 1434(a) amended Code Sec. 4052 by adding at the end a new subsection (f) to read as above.

The above amendment is effective January 1, 1998.

(g) REGULATIONS.—The Secretary shall prescribe regulations which permit, in lieu of any other certification, persons who are purchasing articles taxable under this subchapter for resale or leasing in a long-term lease to execute a statement (made under penalties of perjury) on the sale invoice that such sale is for resale. The Secretary shall not impose any registration requirement as a condition of using such procedure.

[CCH Explanation at ¶ 1233, 1236 and 1239. Committee Reports at ¶ 12,725 and 12,860.]

Amendment Notes

Act Sec. 1434(b)(2) amended Code Sec. 4052 by adding at the end a new subsection (g) to read as above.

The above amendment is effective January 1, 1998.

[¶ 5479] CODE SEC. 4081. IMPOSITION OF TAX.

(a) TAX IMPOSED.—

* * *

(2) RATES OF TAX.—

(A) IN GENERAL.—The rate of the tax imposed by this section is—

(i) in the case of gasoline other than aviation gasoline, 18.3 cents per gallon,

(ii) in the case of aviation gasoline, 19.3 cents per gallon, and

[Caution: Code Sec. 4081(a)(2)(A)(iii), below, as amended by Act Sec. 1032(b) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.]

(iii) in the case of diesel fuel *or kerosene*, 24.3 cents per gallon.

* * *

Amendment Notes

Act Sec. 901(e) provides:

(e) DELAYED DEPOSITS OF HIGHWAY MOTOR FUEL TAX REVENUES.—Notwithstanding section 6302 of the Internal Revenue Code of 1986, in the case of deposits of taxes imposed by sections 4041 and 4081 (other than subsection (a)(2)(A)(ii)) of the Internal Revenue Code of 1986, the due date for any deposit which would (but for this subsection) be required to be made after July 31, 1998, and before October 1, 1998, shall be October 5, 1998.

Act Sec. 1031(g)[(f)](3) provides:

(g) DELAYED DEPOSITS OF AIRPORT TRUST FUND TAX REVENUES.—Notwithstanding section 6302 of the Internal Revenue Code of 1986—

* * *

(3) in the case of deposits of taxes imposed by sections 4081(a)(2)(A)(ii), 4091, and 4271 of such Code, the due date for any such deposit which would (but for this subsection) be required to be made after July 31, 1998, and before October 1, 1998, shall be October 5, 1998.

Act Sec. 1032(b) amended Code Sec. 4081(a)(2)(A)(iii) by inserting "or kerosene" after "diesel fuel".

The above amendment is effective on July 1, 1998.

Act Sec. 1032(g) provides:

(g) FLOOR STOCK TAXES.—

(1) IMPOSITION OF TAX.—In the case of kerosene which is held on July 1, 1998, by any person, there is hereby imposed a floor stocks tax of 24.4 cents per gallon.

(2) LIABILITY FOR TAX AND METHOD OF PAYMENT.—

(A) LIABILITY FOR TAX.—A person holding kerosene on July 1, 1998, to which the tax imposed by paragraph (1) applies shall be liable for such tax.

(B) METHOD OF PAYMENT.—The tax imposed by paragraph (1) shall be paid in such manner as the Secretary shall prescribe.

(C) TIME FOR PAYMENT.—The tax imposed by paragraph (1) shall be paid on or before August 31, 1998.

(3) DEFINITIONS.—For purposes of this subsection—

(A) HELD BY A PERSON.—Kerosene shall be considered as "held by a person" if title thereto has passed to such person (whether or not delivery to the person has been made).

(B) SECRETARY.—The term "Secretary" means the Secretary of the Treasury or his delegate.

(4) EXCEPTION FOR EXEMPT USES.—The tax imposed by paragraph (1) shall not apply to kerosene held by any person exclusively for any use to the extent a credit or refund of the tax imposed by section 4081 of the Internal Revenue Code of 1986 is allowable for such use.

(5) EXCEPTION FOR FUEL HELD IN VEHICLE TANK.—No tax shall be imposed by paragraph (1) on kerosene held in the tank of a motor vehicle or motorboat.

(6) EXCEPTION FOR CERTAIN AMOUNTS OF FUEL.—

(A) IN GENERAL.—No tax shall be imposed by paragraph (1) on kerosene held on July 1, 1998, by any person if the aggregate amount of kerosene held by such person on such date does not exceed 2,000 gallons. The preceding sentence shall apply only if such person submits to the Secretary (at the time and in the manner required by the Secretary) such information as the Secretary shall require for purposes of this paragraph.

(B) EXEMPT FUEL.—For purposes of subparagraph (A), there shall not be taken into account fuel held by any person which is exempt from the tax imposed by paragraph (1) by reason of paragraph (4) or (5).

(C) CONTROLLED GROUPS.—For purposes of this paragraph—

(i) CORPORATIONS.—

(I) IN GENERAL.—All persons treated as a controlled group shall be treated as 1 person.

(II) CONTROLLED GROUP.—The term "controlled group" has the meaning given to such term by subsection (a) of section 1563 of such Code; except that for such purposes the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in such subsection.

(ii) NONINCORPORATED PERSONS UNDER COMMON CONTROL.—Under regulations prescribed by the Secretary, principles similar to the principles of clause (i) shall apply to a group of persons under common control where 1 or more of such persons is not a corporation.

(7) COORDINATION WITH SECTION 4081.—No tax shall be imposed by paragraph (1) on kerosene to the extent that tax has been (or will be) imposed on such kerosene under section 4081 or 4091 of such Code.

(8) OTHER LAWS APPLICABLE.—All provisions of law, including penalties, applicable with respect to the taxes imposed by section 4081 of such Code shall, insofar as applicable and not inconsistent with the provisions of this subsection, apply with respect to the floor stock taxes imposed by paragraph (1) to the same extent as if such taxes were imposed by such section 4081.

(d) TERMINATION.—

* * *

(2) AVIATION GASOLINE.—The rate of tax specified in subsection (a)(2)(A)(ii) shall be 4.3 cents per gallon—

(A) after December 31, 1996, and before the date which is 7 days after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

(B) after *September 30, 2007.*

(3) LEAKING UNDERGROUND STORAGE TANK TRUST FUND FINANCING RATE.—The Leaking Underground Storage Tank Trust Fund financing rate under subsection (a)(2) *shall apply after September 30, 1997, and before April 1, 2005.*

* * *

[CCH Explanation at ¶ 1201, 1211, 1223 and 1251. Committee Reports at ¶ 10,515, 11,275, 11,285, and 11,290.]

Amendment Notes

Act Sec. 1031(a)(2) amended Code Sec. 4081(d)(2)(B) by striking "September 30, 1997" and inserting "September 30, 2007".

The above amendment is effective on October 1, 1997.

Act Sec. 1033 amended Code Sec. 4081(d)(3) by striking "shall not apply after December 31, 1995" and inserting "shall apply after September 30, 1997, and before April 1, 2005".

The above amendment is effective on the date of the enactment of this Act.

[Caution: The heading for Code Sec. 4082, below, as amended by Act Sec. 1032(e)(3)(A) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.]

[¶ 5481] CODE SEC. 4082. EXEMPTIONS FOR DIESEL FUEL *AND KEROSENE*.

[Caution: Code Sec. 4082(a), below, as amended by Act Sec. 1032(c)(1) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.]

(a) IN GENERAL.—The tax imposed by section 4081 shall not apply to *diesel fuel and kerosene*—

(1) which the Secretary determines is destined for a nontaxable use,

(2) which is indelibly dyed in accordance with regulations which the Secretary shall prescribe, and

(3) which meets such marking requirements (if any) as may be prescribed by the Secretary in regulations.

Such regulations shall allow an individual choice of dye color approved by the Secretary or chosen from any list of approved dye colors that the Secretary may publish.

* * *

Amendment Notes

Act Sec. 1032(c)(1) amended Code Sec. 4082(a) by striking "diesel fuel" each place it appears and inserting "diesel fuel and kerosene".

Act Sec. 1032(e)(3)(A) amended Code Sec. 4082 by inserting "**AND KEROSENE**" in the heading after "**DIESEL FUEL**".

The above amendments are effective on July 1, 1998.

[Caution: Code Sec. 4082(c), below, as amended by Act Sec. 1032(c)(1) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.]

(c) EXCEPTION TO DYEING REQUIREMENTS.—Paragraph (2) of subsection (a) shall not apply with respect to any *diesel fuel and kerosene*—

(1) removed, entered, or sold in a State for ultimate sale or use in an area of such State during the period such area is exempted from the fuel dyeing requirements under subsection (i) of section 211 of the Clean Air Act (as in effect on the date of the enactment of this subsection) by the Administrator of the Environmental Protection Agency under paragraph (4) of such subsection (i) (as so in effect), and

(2) the use of which is certified pursuant to regulations issued by the Secretary.

Amendment Notes

Act Sec. 1032(c)(1) amended Code Sec. 4082(c) by striking "diesel fuel" each place it appears and inserting "diesel fuel and kerosene".

The above amendment is effective on July 1, 1998.

[Caution: Code Sec. 4082(d), below, as added by Act Sec. 1032(c)(2) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.]

(d) ADDITIONAL EXCEPTIONS TO DYEING REQUIREMENTS FOR KEROSENE.—

(1) AVIATION-GRADE KEROSENE.—Subsection (a)(2) shall not apply to a removal, entry, or sale of aviation-grade kerosene (as determined under regulations prescribed by the Secretary) if the person receiving the kerosene is registered under section 4101 with respect to the tax imposed by section 4091.

(2) USE FOR NON-FUEL FEEDSTOCK PURPOSES.—Subsection (a)(2) shall not apply to kerosene—

(A) received by pipeline or vessel for use by the person receiving the kerosene in the manufacture or production of any substance (other than gasoline, diesel fuel, or special fuels referred to in section 4041), or

(B) to the extent provided in regulations, removed or entered—

(i) for such a use by the person removing or entering the kerosene, or

(ii) for resale by such person for such a use by the purchaser, but only if the person receiving, removing, or entering the kerosene and such purchaser (if any) are registered under section 4101 with respect to the tax imposed by section 4081.

(3) WHOLESALE DISTRIBUTORS.—To the extent provided in regulations, subsection (a)(2) shall not apply to a removal, entry, or sale of kerosene to a wholesale distributor of kerosene if such distributor—

(A) is registered under section 4101 with respect to the tax imposed by section 4081 on kerosene, and

(B) sells kerosene exclusively to ultimate vendors described in section 6427(l)(5)(B) with respect to kerosene.

Amendment Notes

Act Sec. 1032(c)(2) amended Code Sec. 4082 by redesignating subsections (d) and (e) as subsections (e) and (f), respectively, and by inserting after subsection (c) a new subsection (d) to read as above.

The above amendment is effective on July 1, 1998.

[*Caution: Code Sec. 4082(e), below, as amended by Act Sec. 1032(c)(1) and redesignated by Act Sec. 1032(c)(2) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

(e) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out this section, including regulations requiring the conspicuous labeling of retail *diesel fuel and kerosene* pumps and other delivery facilities to assure that persons are aware of which fuel is available only for nontaxable uses.

Amendment Notes

Act Sec. 1032(c)(1) amended Code Sec. 4082(d) by striking "diesel fuel" each place it appears and inserting "diesel fuel and kerosene".

Act Sec. 1032(c)(2) amended Code Sec. 4082 by redesignating subsection (d) as subsection (e).

The above amendments are effective on July 1, 1998.

[*Caution: Code Sec. 4082(f), below, as redesignated by Act Sec. 1032(c)(2) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

(f) CROSS REFERENCE.—

For tax on train and certain bus uses of fuel purchased tax-free, see section 4041(a)(1).

[CCH Explanation at ¶ 1211. Committee Reports at ¶ 11,285.]

Amendment Notes

Act Sec. 1032(c)(2) amended Code Sec. 4082 by redesignating subsection (e) as subsection (f).

The above amendment is effective on July 1, 1998.

[¶ 5483] CODE SEC. 4083. DEFINITIONS; SPECIAL RULE; ADMINISTRATIVE AUTHORITY.

(a) TAXABLE FUEL.—For purposes of this subpart—

[*Caution: Code Sec. 4083(a)(1), below, as amended by Act Sec. 1032(a) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

(1) IN GENERAL.—The term "taxable fuel" means—

(A) gasoline,

(B) diesel fuel, *and*

(C) kerosene.

* * *

(3) DIESEL FUEL.—The term "diesel fuel" means any liquid (other than gasoline) which is suitable for use as a fuel in a diesel-powered highway vehicle *or a diesel-powered train.*

Amendment Notes

Act Sec. 902(b)(3) amended Code Sec. 4083(a)(3) by striking ", a diesel-powered train, or a diesel-powered boat" and inserting "or a diesel-powered train".

The above amendment is effective on January 1, 1998.

Act Sec. 1032(a) amended Code Sec. 4083(a) by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by adding a new subparagraph (C) to read as above.

The above amendment is effective on July 1, 1998.

For the provision on floor stocks taxes on kerosene, see Act Sec. 1032(g) in the amendment notes following Code Sec. 4081(a).

[*Caution: Code Sec. 4083(b), below, as amended by Act Sec. 1032(e)(4) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

(b) CERTAIN USES DEFINED AS REMOVAL.—If any person uses taxable fuel (other than in the production of *taxable fuels* or special fuels referred to in section 4041), such use shall for the purposes of this chapter be considered a removal.

* * *

[CCH Explanation at ¶ 1209 and 1211. Committee Reports at ¶ 10,520 and 11,285.]

Amendment Notes

Act Sec. 1032(e)(4) amended Code Sec. 4083(b) by striking "gasoline, diesel fuel," and inserting "taxable fuels".

The above amendment is effective on July 1, 1998.

[¶ 5485] CODE SEC. 4091. IMPOSITION OF TAX.

* * *

(b) RATE OF TAX.—

(3) TERMINATION.—

(A) The rate of tax specified in paragraph (1) shall be 4.3 cents per gallon—

(i) after December 31, 1996, and before the date which is 7 days after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

(ii) after *September 30, 2007.*

(B) The Leaking Underground Storage Tank Fund financing rate shall not apply during any period during which the Leaking Underground Storage Tank Trust Fund financing rate under section 4081 does not apply.

* * *

Amendment Notes

Act Sec. 1031(a)(1) amended Code Sec. 4091(b)(3)(A)(ii) by striking "September 30, 1997" and inserting "September 30, 2007".

The above amendment is effective on October 1, 1997.

Act Sec. 1031(g)[(f)](3) provides:

(g) DELAYED DEPOSITS OF AIRPORT TRUST FUND TAX REVENUES.—Notwithstanding section 6302 of the Internal Revenue Code of 1986—

* * *

(3) in the case of deposits of taxes imposed by sections 4081(a)(2)(A)(ii), 4091, and 4271 of such Code, the due date for any such deposit which would (but for this subsection) be required to be made after July 31, 1998, and before October 1, 1998, shall be October 5, 1998.

(d) REFUND OF TAX-PAID AVIATION FUEL TO REGISTERED PRODUCER OF FUEL.—If—

(1) a producer of aviation fuel is registered under section 4101, and

(2) such producer establishes to the satisfaction of the Secretary that a prior tax was paid (and not credited or refunded) on aviation fuel held by such producer,

then an amount equal to the tax so paid shall be allowed as a refund (without interest) to such producer in the same manner as if it were an overpayment of tax imposed by this section.

[CCH Explanation at ¶ 1201 and 1227. Committee Reports at ¶ 11,275 and 12,875.]

Amendment Notes

Act Sec. 1436(a) amended Code Sec. 4091 by adding at the end a new subsection (d) to read as above.

The above amendment applies to fuel acquired by the producer after September 30, 1997.

[¶ 5487] CODE SEC. 4092. EXEMPTIONS.

* * *

(b) NO EXEMPTION FROM CERTAIN TAXES ON FUEL USED IN COMMERCIAL AVIATION.—In the case of fuel sold for use in commercial aviation (other than supplies for vessels or aircraft within the meaning of section 4221(d)(3)), subsection (a) shall not apply to so much of the tax imposed by section 4091 as is attributable to—

(1) the Leaking Underground Storage Tank Trust Fund financing rate imposed by such section, and

(2) in the case of fuel sold after September 30, 1995, 4.3 cents per gallon of the rate specified in section 4091(b)(1).

For purposes of the preceding sentence, the term "commercial aviation" means any use of an aircraft other than in noncommercial aviation (as defined in *section 4041(c)(2)*).

* * *

[CCH Explanation at ¶ 1206. Committee Reports at ¶ 13,660.]

Amendment Notes

Act Sec. 1601(f)(4)(C) amended Code Sec. 4092(b) by striking "section 4041(c)(4)" and inserting "section 4041(c)(2)".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective August 27, 1996.—CCH.].

[¶ 5489] CODE SEC. 4093. DEFINITIONS.

[Caution: Code Sec. 4093(a), below, as amended by Act Sec. 1032(e)(5) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.]

(a) AVIATION FUEL.—For purposes of this subpart, the term "aviation fuel" means *kerosene and any other liquid* (other than any product taxable under section 4081) which is suitable for use as a fuel in an aircraft.

* * *

[CCH Explanation at ¶ 1211. Committee Reports at ¶ 11,285.]

Amendment Notes

Act Sec. 1032(e)(5) amended Code Sec. 4093(a) by striking "any liquid" and inserting "kerosene and any other liquid".

The above amendment is effective on July 1, 1998.

[¶ 5491] CODE SEC. 4101. REGISTRATION AND BOND.

* * *

[Caution: Code Sec. 4101(e), below, as added by Act Sec. 1032(d) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.]

(e) CERTAIN APPROVED TERMINALS OF REGISTERED PERSONS REQUIRED TO OFFER DYED DIESEL FUEL AND KEROSENE FOR NONTAXABLE PURPOSES.—

(1) IN GENERAL.—A terminal for kerosene or diesel fuel may not be an approved facility for storage of non-tax-paid diesel fuel or kerosene under this section unless the operator of such terminal offers dyed diesel fuel and kerosene for removal for nontaxable use in accordance with section 4082(a).

(2) EXCEPTION.—Paragraph (1) shall not apply to any terminal exclusively providing aviation-grade kerosene by pipeline to an airport.

* * *

[CCH Explanation at ¶ 1211. Committee Reports at ¶ 11,285.]

Amendment Notes

Act Sec. 1032(d) amended Code Sec. 4101 by adding at the end a new subsection (e) to read as above.

The above amendment is effective on July 1, 1998.

[¶ 5493] CODE SEC. 4131. IMPOSITION OF TAX.

* * *

(b) AMOUNT OF TAX.—

(1) IN GENERAL.—The amount of the tax imposed by subsection (a) shall be 75 cents per dose of any taxable vaccine.

(2) COMBINATIONS OF VACCINES.—If any taxable vaccine is described in more than 1 subparagraph of section 4132(a)(1), the amount of the tax imposed by subsection (a) on such vaccine shall be the sum of the amounts for the vaccines which are so included.

* * *

[CCH Explanation at ¶ 1255. Committee Reports at ¶ 10,530.]

Amendment Notes

Act Sec. 904(a) amended Code Sec. 4131(b) to read as above. Prior to amendment, Code Sec. 4131(b) read as follows:

(b) AMOUNT OF TAX.—

(1) IN GENERAL.—The amount of the tax imposed by subsection (a) shall be determined in accordance with the following table:

If the taxable vaccine is:	*The tax per dose is:*
DPT vaccine	$4.56
DT vaccine	0.06
MMR vaccine	4.44
Polio vaccine	0.29.

(2) COMBINATIONS OF VACCINES.—If any taxable vaccine is included in more than 1 category of vaccines in the table contained in paragraph (1), the amount of the tax imposed by subsection (a) on such vaccine shall be the sum of the amounts determined under such table for each category in which such vaccine is so included.

The above amendment is effective on the day after the date of the enactment of this Act.

[¶ 5495] CODE SEC. 4132. DEFINITIONS AND SPECIAL RULES.

(a) DEFINITIONS RELATING TO TAXABLE VACCINES.—For purposes of this subchapter—

(1) TAXABLE VACCINE.—The term "taxable vaccine" means any of the following vaccines which are manufactured or produced in the United States or entered into the United States for consumption, use, or warehousing:

(A) Any vaccine containing diphtheria toxoid.

(B) Any vaccine containing tetanus toxoid.

(C) Any vaccine containing pertussis bacteria, extracted or partial cell bacteria, or specific pertussis antigens.

(D) Any vaccine against measles.

(E) Any vaccine against mumps.

(F) Any vaccine against rubella.

(G) Any vaccine containing polio virus.

(H) Any HIB vaccine.

(I) Any vaccine against hepatitis B.

(J) Any vaccine against chicken pox.

(2) VACCINE.—The term "vaccine" means any substance designed to be administered to a human being for the prevention of 1 or more diseases.

(3) UNITED STATES.—The term "United States" has the meaning given such term by section 4612(a)(4).

(4) IMPORTER.—The term "importer" means the person entering the vaccine for consumption, use, or warehousing.

* * *

[CCH Explanation at ¶ 1255. Committee Reports at ¶ 10,530.]

Amendment Notes

Act Sec. 904(b) amended Code Sec. 4132(a)(1) to read as above. Prior to amendment, Code Sec. 4132(a)(1) read as follows:

(1) TAXABLE VACCINE.—The term "taxable vaccine" means any vaccine—

(A) which is listed in the table contained in section 4131(b)(1), and

(B) which is manufactured or produced in the United States or entered into the United States for consumption, use, or warehousing.

Act Sec. 904(c) amended Code Sec. 4132(a) by striking paragraphs (2), (3), (4), and (5) and by redesignating paragraphs (6) through (8) as paragraphs (2) through (4), respectively. Prior to amendment, Code Sec. 4132(a)(2)-(5) read as follows:

(2) DPT VACCINE.—The term "DPT vaccine" means any vaccine containing pertussis bacteria, extracted or partial cell bacteria, or specific pertussis antigens.

(3) DT VACCINE.—The term "DT vaccine" means any vaccine (other than a DPT vaccine) containing diphtheria toxoid or tetanus toxoid.

(4) MMR VACCINE.—The term "MMR vaccine" means any vaccine against measles, mumps, or rubella. Not more than 1 tax shall be imposed by section 4131 on any MMR vaccine by reason of being a vaccine against more than 1 of measles, mumps, or rubella.

(5) POLIO VACCINE.—The term "polio vaccine" means any vaccine containing polio virus.

The above amendments are effective on the day after the date of the enactment of this Act. For a special rule, see Act Sec. 904(e), below.

Act Sec. 904(e) provides:

(e) LIMITATION ON CERTAIN CREDITS OR REFUNDS.—For purposes of applying section 4132(b) of the Internal Revenue Code of 1986 with respect to any claim for credit or refund filed before January 1, 1999, the amount of tax taken into account shall not exceed the tax computed under the rate in effect on the day after the date of the enactment of this Act.

[¶ 5497] CODE SEC. 4161. IMPOSITION OF TAX.

* * *

(b) BOWS AND ARROWS, ETC.—

(1) BOWS.—

(A) IN GENERAL.—There is hereby imposed on the sale by the manufacturer, producer, or importer of any bow which has a draw weight of 10 pounds or more, a tax equal to 11 percent of the price for which so sold.

(B) PARTS AND ACCESSORIES.—There is hereby imposed upon the sale by the manufacturer, producer, or importer—

(i) of any part of accessory suitable for inclusion in or attachment to a bow described in subparagraph (A), and

(ii) of any quiver suitable for use with arrows described in paragraph (2), a tax equivalent to 11 percent of the price for which so sold.

(2) ARROWS.—There is hereby imposed on the sale by the manufacturer, producer, or importer of any shaft, point, nock, or vane of a type used in the manufacture of any arrow which after its assembly—

(A) measures 18 inches overall or more in length, or

(B) measures less than 18 inches overall in length but is suitable for use with a bow described in paragraph (1)(A),

a tax equal to 12.4 percent of the price for which so sold.

(3) COORDINATION WITH SUBSECTION (a).—No tax shall be imposed under this subsection with respect to any article taxable under subsection (a).

* * *

[CCH Explanation at ¶ 1270. Committee Reports at ¶ 12,855.]

Amendment Notes

Act Sec. 1433(a) amended Code Sec. 4161(b) to read as above. Prior to amendment, Code Sec. 4161(b) read as follows:

(b) BOWS AND ARROWS, ETC.—

(1) BOWS AND ARROWS.—There is hereby imposed on the sale by the manufacturer, producer, or importer—

(A) of any bow which has a draw weight of 10 pounds or more, and

(B) of any arrow which—

(i) measures 18 inches overall or more in length, or

(ii) measures less than 18 inches overall in length but is suitable for use with a bow described in subparagraph (A),

a tax equal to 11 percent of the price for which so sold.

(2) PARTS AND ACCESSORIES.—There is hereby imposed upon the sale by the manufacturer, producer, or importer—

(A) of any part or accessory suitable for inclusion in or attachment to a bow or arrow described in paragraph (1), and

(B) of any quiver suitable for use with arrows described in paragraph (1),

a tax equivalent to 11 percent of the price for which so sold.

(3) COORDINATION WITH SUBSECTION (a).—No tax shall be imposed under this subsection with respect to any article taxable under subsection (a).

The above amendment applies to articles sold by the manufacturer, producer, or importer after September 30, 1997.

[¶ 5499] CODE SEC. 4222. REGISTRATION.

* * *

(b) EXCEPTIONS.—

* * *

(2) *UNDER REGULATIONS.*—Subject to such regulations as the Secretary may prescribe for the purpose of this paragraph, the Secretary may relieve the purchaser or the second purchaser, or both, from the requirement of registering under this section.

* * *

[CCH Explanation at ¶ 1290. Committee Reports at ¶ 12,845.]

Amendment Notes

Act Sec. 1431(a)(1)-(2) amended Code Sec. 4222(b)(2) by striking "in the case of any sale or resale for export," after "paragraph," and by striking "EXPORT" and inserting "UNDER REGULATIONS" in the heading.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5501] CODE SEC. 4251. IMPOSITION OF TAX.

* * *

(d) TREATMENT OF PREPAID TELEPHONE CARDS.—

(1) IN GENERAL.—For purposes of this subchapter, in the case of communications services acquired by means of a prepaid telephone card—

(A) the face amount of such card shall be treated as the amount paid for such communications services, and

(B) that amount shall be treated as paid when the card is transferred by any telecommunications carrier to any person who is not such a carrier.

(2) DETERMINATION OF FACE AMOUNT IN ABSENCE OF SPECIFIED DOLLAR AMOUNT.—In the case of any prepaid telephone card which entitles the user other than to a specified dollar amount of use, the face amount shall be determined under regulations prescribed by the Secretary.

(3) PREPAID TELEPHONE CARD.—For purposes of this subsection, the term "prepaid telephone card" means any card or other similar arrangement which permits its holder to obtain communications services and pay for such services in advance.

* * *

[CCH Explanation at ¶ 1253. Committee Reports at ¶ 11,295.]

Amendment Notes

Act Sec. 1034(a) amended Code Sec. 4251 by adding at the end a new subsection (d) to read as above.

The above amendment applies to amounts paid in calendar months beginning more than 60 days after the date of the enactment of this Act.

[¶ 5503] CODE SEC. 4261. IMPOSITION OF TAX.

(a) IN GENERAL.—There is hereby imposed on the amount paid for taxable transportation of any person a tax equal to 7.5 percent of the amount so paid.

Amendment Notes

Act Sec. 1031(c)(1) amended Code Sec. 4261 by striking subsection (a) and inserting a new subsection (a) to read as above. Prior to being stricken, Code Sec. 4261(a) read as follows:

(a) IN GENERAL.—There is hereby imposed upon the amount paid for taxable transportation (as defined in section 4262) of any person a tax equal to 10 percent of the amount so paid. In the case of amounts paid outside of the United States for taxable transportation, the tax imposed by this subsection shall apply only if such transportation begins and ends in the United States.

The above amendment generally applies to transportation beginning on or after October 1, 1997. For special rules, see Act Sec. 1031(e)(2)(B) and (g)[(f)], below.

Act Sec. 1031(e)(2)(B) provides:

(B) TREATMENT OF AMOUNTS PAID FOR TICKETS PURCHASED BEFORE OCTOBER 1, 1997.—The amendments made by subsection (c) shall not apply to amounts paid before October 1, 1997; except that—

(i) the amendment made to section 4261(c) of the Internal Revenue Code of 1986 shall apply to amounts paid more than 7 days after the date of the enactment of this Act for transportation beginning on or after October 1, 1997, and

(ii) the amendment made to section 4263(c) of such Code shall apply to the extent related to taxes imposed under the amendment made to such section 4261(c) on the amounts described in clause (i).

Act Sec. 1031(g)[(f)] provides:

(g)[(f)] DELAYED DEPOSITS OF AIRPORT TRUST FUND TAX REVENUES.—Notwithstanding section 6302 of the Internal Revenue Code of 1986—

(1) in the case of deposits of taxes imposed by section 4261 of such Code, the due date for any such deposit which would (but for this subsection) be required to be made after August 14, 1997, and before October 1, 1997, shall be October 10, 1997,

(2) in the case of deposits of taxes imposed by section 4261 of such Code, the due date for any such deposit which would (but for this subsection) be required to be made after August 14, 1998, and before October 1, 1998, shall be October 5, 1998, and

(3) in the case of deposits of taxes imposed by sections 4081(a)(2)(A)(ii), 4091, and 4271 of such Code, the due date for any such deposit which would (but for this subsection) be required to be made after July 31, 1998, and before October 1, 1998, shall be October 5, 1998.

(b) DOMESTIC SEGMENTS OF TAXABLE TRANSPORTATION.—

(1) IN GENERAL.—There is hereby imposed on the amount paid for each domestic segment of taxable transportation by air a tax in the amount determined in accordance with the following table for the period in which the segment begins:

In the case of segments beginning:	*The tax is:*
After September 30, 1997, and before October 1, 1998	*$1.00*
After September 30, 1998, and before October 1, 1999	*$2.00*
After September 30, 1999, and before January 1, 2000	*$2.25*
During 2000	*$2.50*
During 2001	*$2.75*
During 2002 or thereafter	*$3.00*

(2) DOMESTIC SEGMENT.—For purposes of this section, the term "domestic segment" means any segment consisting of 1 takeoff and 1 landing and which is taxable transportation described in section 4262(a)(1).

(3) CHANGES IN SEGMENTS BY REASON OF REROUTING.—If—

(A) transportation is purchased between 2 locations on specified flights, and

(B) there is a change in the route taken between such 2 locations which changes the number of domestic segments, but there is no change in the amount charged for such transportation,

the tax imposed by paragraph (1) shall be determined without regard to such change in route.

Amendment Notes

Act Sec. 1031(c)(1) amended Code Sec. 4261 by striking subsection (b) and inserting a new subsection (b) to read as above. Prior to being stricken, Code Sec. 4261(b) read as follows:

(b) SEATS, BERTHS, ETC.—There is hereby imposed upon the amount paid for seating or sleeping accommodations in connection with transportation and with respect to which a tax is imposed by subsection (a), a tax equal to 10 percent of the amount so paid.

The above amendment generally applies to transportation beginning on or after October 1, 1997. For special rules, see Act Sec. 1031(e)(2)(B), below, and Act Sec. 1031(g)[(f)] in the amendment notes following Code Sec. 4261(a).

Act Sec. 1031(e)(2)(B) provides:

(B) TREATMENT OF AMOUNTS PAID FOR TICKETS PURCHASED BEFORE OCTOBER 1, 1997.—The amendments made by subsection (c) shall not apply to amounts paid before October 1, 1997; except that—

(i) the amendment made to section 4261(c) of the Internal Revenue Code of 1986 shall apply to amounts paid more than 7 days after the date of the enactment of this Act for transportation beginning on or after October 1, 1997, and

(ii) the amendment made to section 4263(c) of such Code shall apply to the extent related to taxes imposed under the amendment made to such section 4261(c) on the amounts described in clause (i).

(c) USE OF INTERNATIONAL TRAVEL FACILITIES.—

(1) IN GENERAL.—There is hereby imposed a tax of $12.00 on any amount paid (whether within or without the United States) for any transportation of any person by air, if such transportation begins or ends in the United States.

(2) EXCEPTION FOR TRANSPORTATION ENTIRELY TAXABLE UNDER SUBSECTION (a).—This subsection shall not apply to any transportation all of which is taxable under subsection (a) (determined without regard to sections 4281 and 4282).

(3) SPECIAL RULE FOR ALASKA AND HAWAII.—In any case in which the tax imposed by paragraph (1) applies to a domestic segment beginning or ending in Alaska or Hawaii, such tax shall apply only to departures and shall be at the rate of $6.

* * *

Amendment Notes

Act Sec. 1031(c)(1) amended Code Sec. 4261 by striking subsection (c) and inserting a new subsection (c) to read as above. Prior to being stricken, Code Sec. 4261(c) read as follows:

(c) USE OF INTERNATIONAL TRAVEL FACILITIES.—There is hereby imposed a tax of $6 upon any amount paid (whether within or without the United States) for any transportation of any person by air, if such transportation begins in the United States. This subsection shall not apply to any transportation all of which is taxable under subsection (a) (determined without regard to sections 4281 and 4282).

The above amendment generally applies to transportation beginning on or after October 1, 1997. For special rules, see Act Sec. 1031(e)(2)(B), below, and Act Sec. 1031(g)[(f)] in the amendment notes following Code Sec. 4261(a).

Act Sec. 1031(e)(2)(B) provides:

(B) TREATMENT OF AMOUNTS PAID FOR TICKETS PURCHASED BEFORE OCTOBER 1, 1997.—The amendments made by subsection (c) shall not apply to amounts paid before October 1, 1997; except that—

(i) the amendment made to section 4261(c) of the Internal Revenue Code of 1986 shall apply to amounts paid more than 7 days after the date of the enactment of this Act for transportation beginning on or after October 1, 1997, and

(ii) the amendment made to section 4263(c) of such Code shall apply to the extent related to taxes imposed under the amendment made to such section 4261(c) on the amounts described in clause (i).

(e) SPECIAL RULES.—

(1) SEGMENTS TO AND FROM RURAL AIRPORTS.—

(A) EXCEPTION FROM SEGMENT TAX.—The tax imposed by subsection (b)(1) shall not apply to any domestic segment beginning or ending at an airport which is a rural airport for the calendar year in which such segment begins or ends (as the case may be).

(B) RURAL AIRPORT.—For purposes of this paragraph, the term "rural airport" means, with respect to any calendar year, any airport if—

(i) there were fewer than 100,000 commercial passengers departing by air during the second preceding calendar year from such airport, and

(ii) such airport—

(I) is not located within 75 miles of another airport which is not described in clause (i), or

(II) is receiving essential air service subsidies as of the date of the enactment of this paragraph.

(C) NO PHASEIN OF REDUCED TICKET TAX.—In the case of transportation beginning before October 1, 1999—

(i) IN GENERAL.—Paragraph (5) shall not apply to any domestic segment beginning or ending at an airport which is a rural airport for the calendar year in which such segment begins or ends (as the case may be).

(ii) TRANSPORTATION INVOLVING MULTIPLE SEGMENTS.—In the case of transportation involving more than 1 domestic segment at least 1 of which does not begin or end at a rural airport, the 7.5 percent rate applicable by reason of clause (i) shall be applied by taking into account only an amount which bears the same ratio to the amount paid for such transportation as the number of specified miles in domestic segments which begin or end at a rural airport bears to the total number of specified miles in such transportation.

(2) AMOUNTS PAID OUTSIDE THE UNITED STATES.—In the case of amounts paid outside the United States for taxable transportation, the taxes imposed by subsections (a) and (b) shall apply only if such transportation begins and ends in the United States.

(3) AMOUNTS PAID FOR RIGHT TO AWARD FREE OR REDUCED RATE AIR TRANSPORTATION.—

(A) IN GENERAL.—Any amount paid (and the value of any other benefit provided) to an air carrier (or any related person) for the right to provide mileage awards for (or other reductions in the cost of) any transportation of persons by air shall be treated for purposes of subsection (a) as an amount paid for taxable transportation, and such amount shall be taxable under subsection (a) without regard to any other provision of this subchapter.

(B) CONTROLLED GROUP.—For purposes of subparagraph (A), a corporation and all wholly owned subsidiaries of such corporation shall be treated as 1 corporation.

(C) REGULATIONS.—The Secretary shall prescribe rules which reallocate items of income, deduction, credit, exclusion, or other allowance to the extent necessary to prevent the avoidance of tax imposed by reason of this paragraph. The Secretary may prescribe rules which exclude from the tax imposed by subsection (a) amounts attributable to mileage awards which are used other than for transportation of persons by air.

(4) INFLATION ADJUSTMENT OF DOLLAR RATES OF TAX.—

(A) IN GENERAL.—In the case of taxable events in a calendar year after the last nonindexed year, the $3.00 amount contained in subsection (b) and each dollar amount contained in subsection (c) shall be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting the year before the last nonindexed year for "calendar year 1992" in subparagraph (B) thereof.

If any increase determined under the preceding sentence is not a multiple of 10 cents, such increase shall be rounded to the nearest multiple of 10 cents.

(B) LAST NONINDEXED YEAR.—For purposes of subparagraph (A), the last nonindexed year is—

(i) 2002 in the case of the $3.00 amount contained in subsection (b), and

(ii) 1998 in the case of the dollar amounts contained in subsection (c).

(C) TAXABLE EVENT.—For purposes of subparagraph (A), in the case of the tax imposed subsection (b), the beginning of the domestic segment shall be treated as the taxable event.

(5) RATES OF TICKET TAX FOR TRANSPORTATION BEGINNING BEFORE OCTOBER 1, 1999.—Subsection (a) shall be applied by substituting for "7.5 percent"—

(A) "9 percent" in the case of transportation beginning after September 30, 1997, and before October 1, 1998, and

(B) "8 percent" in the case of transportation beginning after September 30, 1998, and before October 1, 1999.

Amendment Notes

Act Sec. 1031(c)(2) amended Code Sec. 4261 by redesignating subsections (e), (f), and (g) as subsections (f), (g), and (h), respectively, and by inserting after subsection (d) a new subsection (e) to read as above.

The above amendment generally applies to transportation beginning on or after October 1, 1997. For special rules, see Act Sec. 1031(e)(2)(B)-(C), below.

Act Sec. 1031(e)(2)(B)-(C) provides:

(B) TREATMENT OF AMOUNTS PAID FOR TICKETS PURCHASED BEFORE OCTOBER 1, 1997.—The amendments made by subsection (c) shall not apply to amounts paid before October 1, 1997; except that—

(i) the amendment made to section 4261(c) of the Internal Revenue Code of 1986 shall apply to amounts paid more than 7 days after the date of the enactment of this Act for transportation beginning on or after October 1, 1997, and

(ii) the amendment made to section 4263(c) of such Code shall apply to the extent related to taxes imposed under the amendment made to such section 4261(c) on the amounts described in clause (i).

(C) AMOUNTS PAID FOR RIGHT TO AWARD MILEAGE AWARDS.—

(i) IN GENERAL.—Paragraph (3) of section 4261(e) of the Internal Revenue Code of 1986 (as added by the amendment made by subsection (c)) shall apply to amounts paid (and other benefits provided) after September 30, 1997.

(ii) PAYMENTS WITHIN CONTROLLED GROUP.—For purposes of clause (i), any amount paid after June 11, 1997, and before October 1, 1997, by 1 member of a controlled group for a right which is described in such section 4261(e)(3) and is furnished by another member of such group after September 30, 1997, shall be treated as paid after September 30, 1997. For purposes of the preceding sentence, all persons treated as a single employer under subsection (a) or (b) of section 52 of such Code shall be treated as members of a controlled group.

(f) EXEMPTION FOR CERTAIN HELICOPTER USES.—No tax shall be imposed under subsection (a) or (b) on air transportation by helicopter for the purpose of—

(1) transporting individuals, equipment, or supplies in the exploration for, or the development or removal of, hard minerals, oil, or gas, or

(2) the planting, cultivation, cutting, or transportation of, or caring for, trees (including logging operations),

but only if the helicopter does not take off from, or land at, a facility eligible for assistance under the Airport and Airway Development Act of 1970, or otherwise use services provided pursuant to section 44509 or 44913(b) or subchapter I of chapter 471 of title 49, United States Code, during such use. In the case of helicopter transportation described in paragraph (1), this subsection shall be applied by treating each flight segment as a distinct flight.

Amendment Notes

Act Sec. 1031(c)(2) amended Code Sec. 4261 by redesignating subsection (e) as subsection (f).

The above amendment generally applies to transportation beginning on or after October 1, 1997. For special rules, see Act Sec. 1031(e)(2)(B)-(C) in the amendment notes following Code Sec. 4261(e), above.

(g) EXEMPTION FOR AIR AMBULANCES PROVIDING CERTAIN EMERGENCY MEDICAL TRANSPORTATION.—No tax shall be imposed under this section or section 4271 on any air transportation for the purpose of providing emergency medical services—

(1) by helicopter, or

(2) by a fixed-wing aircraft equipped for and exclusively dedicated *on that flight* to acute care emergency medical services.

Amendment Notes

Act Sec. 1031(c)(2) amended Code Sec. 4261 by redesignating subsection (f) as subsection (g).

The above amendment generally applies to transportation beginning on or after October 1, 1997. For special rules, see Act Sec. 1031(e)(2)(B)-(C) in the amendment notes following Code Sec. 4261(e), above.

Act Sec. 1601(f)(4)(D) amended Code Sec. 4261(g), as redesignated by Act Sec. 1031(c)(2), by inserting "on that flight" after "dedicated".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective August 27, 1996.—CCH.].

(h) EXEMPTION FOR SKYDIVING USES.—No tax shall be imposed by this section or section 4271 on any air transportation exclusively for the purpose of skydiving.

Amendment Notes

Act Sec. 1435(a) amended Code Sec. 4261, as amended by Act Sec. 1031(c)(2), by redesignating subsection (h) as subsection (i) and by inserting after subsection (g) a new subsection (h) to read as above.

The above amendment applies to amounts paid after September 30, 1997.

(i) APPLICATION OF TAXES.—

(1) IN GENERAL.—The taxes imposed by this section shall apply to—

(A) transportation beginning during the period—

(i) beginning on the 7th day after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

(ii) ending on *September 30, 2007,* and

(B) amounts paid during such period for transportation beginning after such period.

(2) REFUNDS.—If, as of the date any transportation begins, the taxes imposed by this section would not have applied to such transportation if paid for on such date, any tax paid under paragraph (1)(B) with respect to such transportation shall be treated as an overpayment.

* * *

[CCH Explanation at ¶ 1201, 1206 and 1221. Committee Reports at ¶ 11,275, 12,870 and 13,660.]

Amendment Notes

Act Sec. 1031(b)(1) amended Code Sec. 4261(g)(1)(A)(ii) by striking "September 30, 1997" and inserting "September 30, 2007".

The above amendment generally applies to transportation beginning on or after October 1, 1997. For a special rule, see Act Sec. 1031(e)(2)(B)-(C) in the amendment notes following Code Sec. 4261(e), above.

Act Sec. 1031(c)(2) amended Code Sec. 4261 by redesignating subsection (g) as subsection (h).

The above amendment generally applies to transportation beginning on or after October 1, 1997. For special rules, see Act Sec. 1031(e)(2)(B)-(C) in the amendment notes following Code Sec. 4261(e), above.

Act Sec. 1435(a) amended Code Sec. 4261, as amended by Act Sec. 1031(c)(2), by redesignating subsection (h) as subsection (i).

The above amendment applies to amounts paid after September 30, 1997.

[¶ 5505] CODE SEC. 4263. SPECIAL RULES.

* * *

(c) PAYMENT OF TAX.—Where any tax imposed by section 4261 is not paid at the time payment for transportation is made, then, under regulations prescribed by the Secretary, to the extent that such tax is not collected under any other provision of this *subchapter, such tax shall be paid by the carrier providing the initial segment of such transportation which begins or ends in the United States.*

* * *

[CCH Explanation at ¶ 1201. Committee Reports at ¶ 11,275.]

Amendment Notes

Act Sec. 1031(c)(3) amended Code Sec. 4263(c) by striking "subchapter—" and all that follows and inserting "subchapter, such tax shall be paid by the carrier providing the initial segment of such transportation which begins or ends in the United States." Prior to amendment, Code Sec. 4263(c) read as follows:

(c) PAYMENT OF TAX.—Where any tax imposed by section 4261 is not paid at the time payment for transportation is made, then, under regulations prescribed by the Secretary, to the extent that such tax is not collected under any other provision of this subchapter—

(1) such tax shall be paid by the person paying for the transportation or by the person using the transportation;

(2) such tax shall be paid within such time as the Secretary shall prescribe by regulations after whichever of the following first occurs:

(A) the rights to the transportation expire; or

(B) the time when the transportation becomes subject to tax; and

(3) payment of such tax shall be made to the Secretary, to the person to whom the payment for transportation was made, or, in the case of transportation other than transportation described in section 4262(a)(1), to any person furnishing any portion of such transportation.

The above amendment generally applies to transportation beginning on or after October 1, 1997. For a special rule, see Act Sec. 1031(e)(2)(B), below.

Act Sec. 1031(e)(2)(B) provides:

(B) TREATMENT OF AMOUNTS PAID FOR TICKETS PURCHASED BEFORE OCTOBER 1, 1997.—The amendments made by subsection (c) shall not apply to amounts paid before October 1, 1997; except that—

(i) the amendment made to section 4261(c) of the Internal Revenue Code of 1986 shall apply to amounts paid more than 7 days after the date of the enactment of this Act for transportation beginning on or after October 1, 1997, and

(ii) the amendment made to section 4263(c) of such Code shall apply to the extent related to taxes imposed under the amendment made to such section 4261(c) on the amounts described in clause (i).

[¶ 5507] CODE SEC. 4271. IMPOSITION OF TAX.

* * *

(d) APPLICATION OF TAX.—

(1) IN GENERAL.—The tax imposed by subsection (a) shall apply to—

(A) transportation beginning during the period—

(i) beginning on the 7th day after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

(ii) ending on *September 30, 2007,* and

(B) amounts paid during such period for transportation beginning after such period.

* * *

[CCH Explanation at ¶ 1201. Committee Reports at ¶ 11,275.]

Amendment Notes

Act Sec. 1031(b)(2) amended Code Sec. 4271(d)(1)(A)(ii) by striking "September 30, 1997" and inserting "September 30, 2007".

The above amendment generally applies to transportation beginning on or after October 1, 1997.

Act Sec. 1031(g)[(f)](3) provides:

(g) DELAYED DEPOSITS OF AIRPORT TRUST FUND TAX REVENUES.—Notwithstanding section 6302 of the Internal Revenue Code of 1986—

* * *

(3) in the case of deposits of taxes imposed by sections 4081(a)(2)(A)(ii), 4091, and 4271 of such Code, the due date for any such deposit which would (but for this subsection) be required to be made after July 31, 1998, and before October 1, 1998, shall be October 5, 1998.

[¶ 5509] CODE SEC. 4495. IMPOSITION OF TAX. *[REPEALED.]*

[CCH Explanation at ¶ 1291. Committee Reports at ¶ 12,850.]

Amendment Notes

Act Sec. 1432(b)(1) repealed subchapter F of chapter 36 (Code Secs. 4495-4498). Prior to repeal, Code Sec. 4495 read as follows:

SEC. 4495. IMPOSITION OF TAX.

(a) GENERAL RULE.—There is hereby imposed a tax on any removal of a hard mineral resource from the deep seabed pursuant to a deep seabed permit.

(b) AMOUNT OF TAX.—The amount of the tax imposed by subsection (a) on any removal shall be 3.75 percent of the imputed value of the resource so removed.

(c) LIABILITY FOR TAX.—The tax imposed by subsection (a) shall be paid by the person to whom the deep seabed permit is issued.

(d) TIME FOR PAYING TAX.—The time for paying the tax imposed by subsection (a) shall be the time prescribed by the Secretary by regulations. The time so prescribed with respect to any removal shall be not earlier than the earlier of—

(1) the commercial use of, or the sale or disposition of, any portion of the resource so removed, or

(2) the day which is 12 months after the date of the removal of the resource.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5511] CODE SEC. 4496. DEFINITIONS. *[REPEALED.]*

[CCH Explanation at ¶ 1291. Committee Reports at ¶ 12,850.]

Amendment Notes

Act Sec. 1432(b)(1) repealed Code Sec. 4496. Prior to repeal, Code Sec. 4496 read as follows:

SEC. 4496. DEFINITIONS.

(a) DEEP SEABED PERMIT.—For purposes of this subchapter, the term "deep seabed permit" means a permit issued under title I of the Deep Seabed Hard Minerals Resources Act.

(b) HARD MINERAL RESOURCE.—For purposes of this subchapter, the term "hard mineral resource" means any deposit or accretion on, or just below, the surface of the deep seabed of nodules which contain one or more minerals, at least one of which is manganese, nickel, cobalt, or copper.

(c) DEEP SEABED.—For purposes of this subchapter, the term "deep seabed" means the seabed, and the subsoil thereof to a depth of 10 meters, lying seaward of, and outside—

(1) the Continental Shelf of any nation; and

(2) any area of national resource jurisdiction of any foreign nation, if such area extends beyond the Continental Shelf of such nation and such jurisdiction is recognized by the United States.

(d) CONTINENTAL SHELF.—For purposes of this subchapter, the term "Continental Shelf" means—

(1) the seabed and subsoil of the submarine areas adjacent to the coast but outside the area of the territorial sea, to a depth of 200 meters or, beyond that limit, to where the depth of the superjacent waters admits of the exploitation of the natural resources of such areas; and

(2) the seabed and subsoil of similar submarine areas adjacent to the coasts of islands.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5513] CODE SEC. 4497. IMPUTED VALUE. *[REPEALED.]*

[CCH Explanation at ¶ 1291. Committee Reports at ¶ 12,850.]

Amendment Notes

Act Sec. 1432(b)(1) repealed Code Sec. 4497. Prior to repeal, Code Sec. 4497 read as follows:

SEC. 4497. IMPUTED VALUE.

(a) IN GENERAL.—For purposes of this subchapter, the term "imputed value" means, with respect to any hard mineral resource, 20 percent of the fair market value of the commercially recoverable metals and minerals contained in such resource. Such fair market value shall be determined—

(1) as of the date of the removal of the hard mineral resource from the deep seabed; and

(2) as if the metals and minerals contained in such resource were separated from such resource and were in the most basic form for which there is a readily ascertainable market price.

(b) COMMERCIAL RECOVERABILITY.—

(1) MANGANESE, NICKEL, COBALT, AND COPPER.—For purposes of subsection (a), manganese, nickel, cobalt, and copper shall be treated as commercially recoverable.

(2) MINIMUM QUANTITIES AND PERCENTAGES.—The Secretary may by regulations prescribe for each metal or mineral quantities or percentages below which the metal or mineral shall be treated as not commercially recoverable.

(c) SUSPENSION OF TAX WITH RESPECT TO CERTAIN METALS AND MINERALS HELD FOR LATER PROCESSING.—

(1) ELECTION.—The permittee may, in such manner and at such time as may be prescribed by regulations, elect to have the application of the tax suspended with respect to one or more commercially recoverable metals or minerals in the resource which the permittee does not intend to process within one year of the date of extraction. Any metal or mineral affected by such election shall not be taken into account in determining the imputed value of the resource at the time of its removal from the deep seabed. Any suspension under this paragraph with respect to a metal or mineral shall be permanent unless there is a redetermination affecting such metal or mineral under paragraph (2).

(2) LATER COMPUTATION OF TAX.—If the permittee processes any metal or mineral affected by the election under paragraph (1), or if he sells any portion of the resource containing such a metal or mineral, then the amount of the tax under section 4495 shall be redetermined as if there had been no suspension under paragraph (1) with respect to such metal or mineral. In any such case there shall be added to the increase in tax determined under the preceding sentence an amount equal to the interest (at the underpayment rate determined under section 6621) on such increase for the

period from the date prescribed for paying the tax on the resources (determined under section 4495(d)) to the date of the processing or sale.

(d) DETERMINATIONS OF VALUE.—All determinations of value necessary for the application of this subchapter shall be made by the Secretary (after consultation with other appropriate Federal officials) on the basis of the best available information. Such determinations shall be made under procedures established by the Secretary by regulations.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5515] CODE SEC. 4498. TERMINATION. *[REPEALED.]*

* * *

[CCH Explanation at ¶ 1291. Committee Reports at ¶ 12,850.]

Amendment Notes

Act Sec. 1432(b)(1) repealed Code Sec. 4498. Prior to repeal, Code Sec. 4498 read as follows:

SEC. 4498. TERMINATION.

(a) GENERAL RULE.—The tax imposed by section 4495 shall not apply to any removal from the deep seabed after the earlier of—

(1) the date on which an international deep seabed treaty takes effect with respect to the United States, or

(2) the date 10 years after the date of the enactment of this subchapter.

(b) INTERNATIONAL DEEP SEABED TREATY.—For purposes of subsection (a), the term "international deep seabed treaty" means any treaty which—

(1) is adopted by a United Nations Conference on the Law of the Sea, and

(2) requires contributions to an international fund for the sharing of revenues from deep seabed mining.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5517] CODE SEC. 4681. IMPOSITION OF TAX.

* * *

(b) AMOUNT OF TAX.—

(1) OZONE-DEPLETING CHEMICALS.—

(A) IN GENERAL.—The amount of the tax imposed by subsection (a) on each pound of ozone-depleting chemical shall be an amount equal to—

(i) the base tax amount, multiplied by

(ii) the ozone-depletion factor for such chemical.

(B) BASE TAX AMOUNT.—The base tax amount for purposes of subparagraph (A) with respect to any sale or use during any calendar year after 1995 shall be $5.35 increased by 45 cents for each year after 1995.

* * *

[CCH Explanation at ¶ 1291. Committee Reports at ¶ 12,850.]

Amendment Notes

Act Sec. 1432(c)(1) amended Code Sec. 4681(b)(1) by striking subparagraphs (B) and (C) and inserting a new subparagraph (B) to read as above. Prior to being stricken, Code Sec. 4681(b)(1)(B)-(C) read as follows:

(B) BASE TAX AMOUNT.—The base tax amount for purposes of subparagraph (A) with respect to any sale or use during a calendar year before 1996 with respect to any ozone-depleting chemical is the amount determined under the following table for such calendar year:

Calendar year:	*Base tax amount:*
1993	3.35
1994	4.35
1995	5.35

(C) BASE TAX AMOUNT FOR LATER YEARS.—The base tax amount for purposes of subparagraph (A) with respect to any sale or use of an ozone-depleting chemical during a calendar year after the last year specified in the table under subparagraph (B) applicable to such chemical shall be the base tax amount for such last year increased by 45 cents for each year after such last year.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5519] CODE SEC. 4682. DEFINITIONS AND SPECIAL RULES.

* * *

(d) EXCEPTIONS.—

(1) RECYCLING.—No tax shall be imposed by section 4681 on any ozone-depleting chemical which is diverted or recovered in the United States as part of a recycling process (and not as part of the original manufacturing or production process), or on any *recycled Halon-1301 or recycled Halon-2402* imported from any country which is a signatory to the Montreal Protocol on Substances that Deplete the Ozone Layer.

* * *

Amendment Notes

Act Sec. 903(a) amended Code Sec. 4682(d)(1) by striking "recycled halon" and inserting "recycled Halon-1301 or recycled Halon-2402".

The above amendment is effective on the date of the enactment of this Act.

(g) CHEMICALS USED AS PROPELLANTS IN METERED-DOSE INHALERS.—

(1) EXEMPTION FROM TAX.—

(A) IN GENERAL.—No tax shall be imposed by section 4681 on—

(i) any use of any substance as a propellant in metered-dose inhalers, or

(ii) any qualified sale by the manufacturer, producer, or importer of any substance.

(B) QUALIFIED SALE.—For purposes of subparagraph (A), the term "qualified sale" means any sale by the manufacturer, producer, or importer of any substance—

(i) for use by the purchaser as a propellant in metered dose inhalers, or

(ii) for resale by the purchaser to a 2d purchaser for such use by the 2d purchaser.

The preceding sentence shall apply only if the manufacturer, producer, and importer, and the 1st and 2d purchasers (if any) meet such registration requirements as may be prescribed by the Secretary.

(2) OVERPAYMENTS.—If any substance on which tax was paid under this subchapter is used by any person as a propellant in metered-dose inhalers, credit or refund without interest shall be allowed to such person in an amount equal to the tax so paid. Amounts payable under the preceding sentence with respect to uses during the taxable year shall be treated as described in section 34(a) for such year unless claim thereof has been timely filed under this paragraph.

* * *

[CCH Explanation at ¶ 1248 and 1291. Committee Reports at ¶ 10,525 and 12,850.]

Amendment Notes

Act Sec. 1432(c)(2) amended Code Sec. 4682(g) to read as above. Prior to amendment, Code Sec. 4682(g) read as follows:

(g) PHASE-IN OF TAX ON CERTAIN SUBSTANCES.—

(1) TREATMENT FOR 1990.—

(A) HALONS.—The term "ozone-depleting chemical" shall not include halon-1211, halon-1301, or halon-2402 with respect to any sale or use during 1990.

(B) CHEMICALS USED IN RIGID FOAM INSULATION.—No tax shall be imposed by section 4681—

(i) on the use during 1990 of any substance in the manufacture of rigid foam insulation,

(ii) on the sale during 1990 by the manufacturer, producer, or importer of any substance—

(I) for use by the purchaser in the manufacture of rigid foam insulation, or

(II) for resale by the purchaser to a second purchaser for such use by the second purchaser, or

(iii) on the sale or use during 1990 by the importer of any rigid foam insulation.

Clause (ii) shall apply only if the manufacturer, producer, and importer, and the 1st and 2d purchasers (if any) meet such registration requirements as may be prescribed by the Secretary.

(2) TREATMENT FOR 1991, 1992, AND 1993.—

(A) HALONS.—The tax imposed by section 4681 during 1991, 1992, or 1993 by reason of the treatment of halon-1211, halon-1301, and halon-2402 as ozone-depleting chemicals shall be the applicable percentage (determined under the following table) of the amount of such tax which would (but for this subparagraph) be imposed.

In the case of:	The applicable percentage in the case of sales or use during 1993 is:
Halon-1211	2.49
Halon-1301	0.75
Halon-2402	1.24

(B) CHEMICALS USED IN RIGID FOAM INSULATION.—In the case of a sale or use during 1991, 1992, or 1993 on which no tax would have been imposed by reason of paragraph (1)(B) had such sale or use occurred during 1990, the tax imposed by section 4681 shall be the applicable percentage (determined in accordance with the following table) of the amount of such tax which would (but for this subparagraph) be imposed.

In the case of sales or use during:	The applicable percentage is:
1991	18
1992	15
1993	7.46

(3) OVERPAYMENTS WITH RESPECT TO CHEMICALS USED IN RIGID FOAM INSULATION.—If any substance on which tax was paid under this subchapter is used during 1990, 1991, 1992, or 1993 by any person in the manufacture of rigid foam insulation, credit or refund (without interest) shall be allowed to such person an amount equal to the excess of—

(A) the tax paid under this subchapter on such substance, over

(B) the tax (if any) which would be imposed by section 4681 if such substance were used for such use by the manufacturer, producer, or importer thereof on the date of its use by such person.

Amounts payable under the preceding sentence with respect to uses during the taxable year shall be treated as described in section 34(a) for such year unless claim therefor has been timely filed under this paragraph.

(4) CHEMICALS USED AS PROPELLANTS IN METERED-DOSE INHALERS.—

(A) TAX-EXEMPT.—

(i) IN GENERAL.—No tax shall be imposed by section 4681 on—

(I) any use of any substance as a propellant in metered-dose inhalers, or

(II) any qualified sale by the manufacturer, producer, or importer of any substance.

(ii) QUALIFIED SALE.—For purposes of clause (i), the term "qualified sale" means any sale by the manufacturer, producer, or importer of any substance—

(I) for use by the purchaser as a propellant in metered-dose inhalers, or

(II) for resale by the purchaser to a 2d purchaser for such use by the 2d purchaser.

The preceding sentence shall apply only if the manufacturer, producer, and importer, and the 1st and 2d purchasers (if any) meet such registration requirements as may be prescribed by the Secretary.

(B) OVERPAYMENTS.—If any substance on which tax was paid under this subchapter is used by any person as a propellant in metered-dose inhalers, credit or refund without interest shall be allowed to such person in an amount equal to the tax so paid. Amounts payable under the preceding sentence with respect to uses during the taxable year shall be treated as described in section 34(a) for such year unless claim thereof has been timely filed under this subparagraph.

(5) TREATMENT OF METHYL CHLOROFORM.—The tax imposed by section 4681 during 1993 by reason of the treatment of methyl chloroform as an ozone-depleting chemical shall be 63.02 percent of the amount of such tax which would (but for this paragraph) be imposed.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5521] CODE SEC. 4947. APPLICATION OF TAXES TO CERTAIN NONEXEMPT TRUSTS.

* * *

(b) SPECIAL RULES.—

* * *

(4) SECTION 507.—The provisions of section 507(a) shall not apply to a trust which is described in subsection (a)(2) by reason of a distribution of qualified employer securities (as defined in section 664(g)(4)) to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined by section 664(g)).

* * *

[CCH Explanation at ¶ 284. Committee Reports at ¶ 13,435.]

Amendment Notes

Act Sec. 1530(c)(9) amended Code Sec. 4947(b) by inserting after paragraph (3) a new paragraph (4) to read as above.

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

[¶ 5523] CODE SEC. 4962. ABATEMENT OF FIRST TIER TAXES IN CERTAIN CASES.

* * *

(b) QUALIFIED FIRST TIER TAX.—For purposes of this section, the term "qualified first tier tax" means any first tier tax imposed by *subchapter A, C, or D* of this chapter, except that such term shall not include the tax imposed by section 4941(a) (relating to initial tax on self-dealing).

* * *

[CCH Explanation at ¶ 619. Committee Reports at ¶ 13,915.]

Amendment Notes

Act Sec. 1603(a) amended Code Sec. 4962(b) by striking "subchapter A or C" and inserting "subchapter A, C, or D".

The above amendment is effective as if included in the provision of the Taxpayer Bill of Rights 2 (P.L. 104-168) to which such amendment relates [generally effective for excess benefit transactions occurring on or after September 14, 1995.—CCH.].

[¶ 5525] CODE SEC. 4972. TAX ON NONDEDUCTIBLE CONTRIBUTIONS TO QUALIFIED EMPLOYER PLANS.

* * *

(c) NONDEDUCTIBLE CONTRIBUTIONS.—For purposes of this section—

* * *

(6) EXCEPTIONS.—In determining the amount of nondeductible contributions for any taxable year, there shall not be taken into account—

* * *

(B) so much of the contributions to 1 or more defined contribution plans which are not deductible when contributed solely because of section 404(a)(7) as does not exceed the greater of—

(i) the amount of contributions not in excess of 6 percent of compensation (within the meaning of section 404(a)) paid or accrued (during the taxable year for which the contributions were made) to beneficiaries under the plans, or

(ii) the sum of—

(I) the amount of contributions described in section 401(m)(4)(A), plus

(II) the amount of contributions described in section 402(g)(3)(A).

* * *

[CCH Explanation at ¶ 725. Committee Reports at ¶ 13,275.]

Amendment Notes

Act Sec. 1507(a) amended Code Sec. 4972(c)(6)(B) to read as above. Prior to amendment, Code Sec. 4972(c)(6)(B) read as follows:

(B) contributions to 1 or more defined contribution plans which are not deductible when contributed solely because of section 404(a)(7), but only to the extent such contributions do not exceed 6 percent of compensation (within the meaning of section 404(a)) paid or accrued (during the taxable year for which the contributions were made) to beneficiaries under the plans.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5527] CODE SEC. 4973. TAX ON EXCESS CONTRIBUTIONS TO INDIVIDUAL RETIREMENT ACCOUNTS, MEDICAL SAVINGS ACCOUNTS, CERTAIN SECTION 403(b) CONTRACTS, AND CERTAIN INDIVIDUAL RETIREMENT ANNUITIES.

(a) TAX IMPOSED.—In the case of—

(1) an individual retirement account (within the meaning of section 408(a)),

(2) a medical savings account (within the meaning of section 220(d)),

(3) an individual retirement annuity (within the meaning of section 408(b)), a custodial account treated as an annuity contract under section 403(b)(7)(A) (relating to custodial accounts for regulated investment company stock), *or*

(4) an education individual retirement account (as defined in section 530),

there is imposed for each taxable year a tax in an amount equal to 6 percent of the amount of the excess contributions to such individual's accounts or annuities (determined as of the close of the taxable year). The amount of such tax for any taxable year shall not exceed 6 percent of the value of the account or annuity (determined as of the close of the taxable year). In the case of an endowment contract described in section 408(b), the tax imposed by this section does not apply to any amount allocable to life, health, accident, or other insurance under such contract. The tax imposed by this subsection shall be paid by such individual.

* * *

Amendment Notes

Act Sec. 213(d)(1) amended Code Sec. 4973(a) by striking "or" at the end of paragraph (2), by adding "or" at the end of paragraph (3), and by inserting a new paragraph (4) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[*Caution: Code Sec. 4973(d), below, as amended by Act Sec. 4006(b)(1) of the Balanced Budget Act of 1997, applies to tax years beginning after December 31, 1998.—CCH.*]

(d) EXCESS CONTRIBUTIONS TO MEDICAL SAVINGS ACCOUNTS.—For purposes of this section, in the case of medical savings accounts (within the meaning of section 220(d)), the term "excess contributions" means the sum of—

(1) the aggregate amount contributed for the taxable year to the accounts (other than rollover contributions described in section 220(f)(5)) which is neither excludable from gross income under section 106(b) nor allowable as a deduction under section 220 for such year, and

(2) the amount determined under this subsection for the preceding taxable year, reduced by the sum of—

(A) the distributions out of the accounts which were included in gross income under section 220(f)(2), and

(B) the excess (if any) of—

(i) the maximum amount allowable as a deduction under section 220(b)(1) (determined without regard to section 106(b)) for the taxable year, over

(ii) the amount contributed to the accounts for the taxable year.

For purposes of this subsection, any contribution which is distributed out of the medical savings account in a distribution to which section 220(f)(3) *or section 138(c)(3)* applies shall be treated as an amount not contributed.

Amendment Notes

Balanced Budget Act

Act Sec. 4006(b)(1) amended the last sentence of Code Sec. 4973(d) by inserting "or section 138(c)(3)" after "section 220(f)(3)".

The above amendment applies to tax years beginning after December 31, 1998.

(e) EXCESS CONTRIBUTIONS TO EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.—For purposes of this section—

(1) IN GENERAL.—In the case of education individual retirement accounts maintained for the benefit of any 1 beneficiary, the term "excess contributions" means—

(A) the amount by which the amount contributed for the taxable year to such accounts exceeds $500, and

(B) any amount contributed to such accounts for any taxable year if any amount is contributed during such year to a qualified State tuition program for the benefit of such beneficiary.

(2) SPECIAL RULES.—For purposes of paragraph (1), the following contributions shall not be taken into account:

(A) Any contribution which is distributed out of the education individual retirement account in a distribution to which section 530(d)(4)(C) applies.

(B) Any contribution described in section 530(b)(2)(B) to a qualified State tuition program.

(C) Any rollover contribution.

Amendment Notes

Act Sec. 213(d)(2) amended Code Sec. 4973 by adding a new subsection (e) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

(f) EXCESS CONTRIBUTIONS TO ROTH IRAs.—For purposes of this section, in the case of contributions to a Roth IRA (within the meaning of section 408A(b)), the term "excess contributions" means the sum of—

(1) the excess (if any) of—

(A) the amount contributed for the taxable year to such accounts (other than a qualified rollover contribution described in section 408A(e)), over

(B) the amount allowable as a contribution under sections 408A (c)(2) and (c)(3), and

(2) the amount determined under this subsection for the preceding taxable year, reduced by the sum of—

(A) the distributions out of the accounts for the taxable year, and

(B) the excess (if any) of the maximum amount allowable as a contribution under sections 408A (c)(2) and (c)(3) for the taxable year over the amount contributed to the accounts for the taxable year.

For purposes of this subsection, any contribution which is distributed from a Roth IRA in a distribution described in section 408(d)(4) shall be treated as an amount not contributed.

* * *

[CCH Explanation at ¶ 145, 166, 817, 819, 821, 823, 825, 827, 829 and 831. Committee Reports at ¶ 10,185, 10,260 and 20,015.]

Amendment Notes

Act Sec. 302(b) amended Code Sec. 4973(b)[sic], as amended by Act Sec. 213(d)(2), by adding at the end a new subsection (f) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5529] CODE SEC. 4975. TAX ON PROHIBITED TRANSACTIONS.

(a) INITIAL TAXES ON DISQUALIFIED PERSON.—There is hereby imposed a tax on each prohibited transaction. The rate of tax shall be equal to *15 percent* of the amount involved with respect to the prohibited transaction for each year (or part thereof) in the taxable period. The tax imposed by this subsection shall be paid by any disqualified person who participates in the prohibited transaction (other than a fiduciary acting only as such).

* * *

Amendment Notes

Act Sec. 1074(a) amended Code Sec. 4975(a) by striking "10 percent" and inserting "15 percent".

The above amendment applies to prohibited transactions occurring after the date of the enactment of this Act.

(c) PROHIBITED TRANSACTION.—

* * *

(4) SPECIAL RULE FOR MEDICAL SAVINGS ACCOUNTS.—An individual for whose benefit a medical savings account (within the meaning of section 220(d)) is established shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) *if section 220(e)(2) applies to such transaction.*

(5) SPECIAL RULE FOR EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.—An individual for whose benefit an education individual retirement account is established and any contributor to such account shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if section 530(d) applies with respect to such transaction.

Amendment Notes

Act Sec. 213(b)(2) amended Code Sec. 4975(c) by adding a new paragraph (5) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

Act Sec. 1602(a)(5) amended Code Sec. 4975(c)(4) by striking "if, with respect to such transaction" and all that follows and inserting "if section 220(e)(2) applies to such transaction.". Prior to amendment, Code Sec. 4975(c)(4) read as follows:

(4) SPECIAL RULE FOR MEDICAL SAVINGS ACCOUNTS.—An individual for whose benefit a medical savings account (within the meaning of section 220(d)) is established shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be a medical savings account by reason of the application of section 220(e)(2) to such account.

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which such amendment relates [effective for tax years beginning after December 31, 1996.—CCH.].

(d) EXEMPTIONS.—*Except as provided in subsection (f)(6), the prohibitions* provided in subsection (c) shall not apply to—

* * *

Amendment Notes

Act Sec. 1506(b)(1)(B)(i)-(ii) amended Code Sec. 4975(d) by striking "The prohibitions" and inserting "Except as provided in subsection (f)(6), the prohibitions", and by striking the last two sentences thereof. Prior to amendment, the last two sentences of Code Sec. 4975(d) read as follows:

The exemptions provided by this subsection (other than paragraphs (9) and (12)) shall not apply to any transaction with respect to a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c)(3)) in which a plan directly or indirectly lends any part of the corpus or income of the plan to, pays any compensation for personal services rendered to the plan to, or acquires for the plan any property from or sells any property to, any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or a corporation controlled by any such owner-employee through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation. For purposes of the preceding sentence, a shareholder-employee (as defined in section 1379, as in effect on the day before the date of the enactment of the Subchapter S Revision Act of 1982, a participant or beneficiary of an individual retirement account or an individual retirement annuity (as defined in section 408), and an employer or association of employees which establishes such an account or annuity under section 408(c) shall be deemed to be an owner-employee.

The above amendment applies to tax years beginning after December 31, 1997.

(e) DEFINITIONS.—

(1) PLAN.—For purposes of this section, the term "plan" means—

* * *

(D) a medical savings account described in section 220(d),

(E) an education individual retirement account described in section 530, or

(*F*) a trust, plan, account, or annuity which, at any time, has been determined by the Secretary to be described in any preceding subparagraph of this paragraph.

* * *

(7) EMPLOYEE STOCK OWNERSHIP PLAN.—The term "employee stock ownership plan" means a defined contribution plan—

(A) which is a stock bonus plan which is qualified, or a stock bonus and a money purchase plan both of which are qualified under section 401(a) and which are designed to invest primarily in qualifying employer securities; and

(B) which is otherwise defined in regulations prescribed by the Secretary.

A plan shall not be treated as an employee stock ownership plan unless it meets the requirements of section 409(h), section 409(o), and, if applicable, section 409(n) *and section 664(g)* and, if the

employer has a registration-type class of securities (as defined in section 409(e)(4)), it meets the requirements of section 409(e).

* * *

Amendment Notes

Act Sec. 213(b)(1) amended Code Sec. 4975(e)(1) by striking "or" at the end of subparagraph (D), by redesignating subparagraph (E) as subparagraph (F), and by inserting after subparagraph (D) a new subparagraph (E) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

Act Sec. 1530(c)(10) amended Code Sec. 4975(e)(7) by inserting "and section 664(g)" after "section 409(n)" in the last sentence.

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

(f) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

* * *

(6) EXEMPTIONS NOT TO APPLY TO CERTAIN TRANSACTIONS.—

(A) IN GENERAL.—In the case of a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c)(3)), the exemptions provided by subsection (d) (other than paragraphs (9) and (12)) shall not apply to a transaction in which the plan directly or indirectly—

(i) lends any part of the corpus or income of the plan to,

(ii) pays any compensation for personal services rendered to the plan to, or

(iii) acquires for the plan any property from, or sells any property to,

any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or any corporation in which any such owner-employee owns, directly or indirectly, 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

(B) SPECIAL RULES FOR SHAREHOLDER-EMPLOYEES, ETC.—

(i) IN GENERAL.—For purposes of subparagraph (A), the following shall be treated as owner-employees:

(I) A shareholder-employee.

(II) A participant or beneficiary of an individual retirement plan (as defined in section 7701(a)(37)).

(III) An employer or association of employees which establishes such an individual retirement plan under section 408(c).

(ii) EXCEPTION FOR CERTAIN TRANSACTIONS INVOLVING SHAREHOLDER-EMPLOYEES.—Subparagraph (A)(iii) shall not apply to a transaction which consists of a sale of employer securities to an employee stock ownership plan (as defined in subsection (e)(7)) by a shareholder-employee, a member of the family (as defined in section 267(c)(4)) of such shareholder-employee, or a corporation in which such a shareholder-employee owns stock representing a 50 percent or greater interest described in subparagraph (A).

(C) SHAREHOLDER-EMPLOYEE.—For purposes of subparagraph (B), the term "shareholder-employee" means an employee or officer of an S corporation who owns (or is considered as owning within the meaning of section 318(a)(1)) more than 5 percent of the outstanding stock of the corporation on any day during the taxable year of such corporation.

* * *

[CCH Explanation at ¶ 145, 284, 712, 752 and 814. Committee Reports at ¶ 10,185, 11,475, 13,265 and 13,435.]

Amendment Notes

Act Sec. 1506(b)(1)(A) amended Code Sec. 4975(f) by inserting at the end a new paragraph (6) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5531] CODE SEC. 4978. TAX ON CERTAIN DISPOSITIONS BY EMPLOYEE STOCK OWNERSHIP PLANS AND CERTAIN COOPERATIVES.

(a) TAX ON DISPOSITIONS OF SECURITIES TO WHICH SECTION 1042 APPLIES BEFORE CLOSE OF MINIMUM HOLDING PERIOD.—If, during the 3-year period after the date on which the employee stock ownership plan or eligible worker-owned cooperative acquired any qualified securities in a sale to which section 1042

applied *or acquired any qualified employer securities in a qualified gratuitous transfer to which section 664(g) applied,* such plan or cooperative disposes of any qualified securities and—

(1) the total number of shares held by such plan or cooperative after such disposition is less than the total number of employer securities held immediately after such sale, or

(2) except to the extent provided in regulations, the value of qualified securities held by such plan or cooperative after such disposition is less than 30 percent of the total value of all employer securities as of such disposition *60 percent of the total value of all employer securities as of such disposition in the case of any qualified employer securities acquired in a qualified gratuitous transfer to which section 664(g) applied),*

there is hereby imposed a tax on the disposition equal to the amount determined under subsection (b).

Amendment Notes

Act Sec. 1530(c)(11)(A)-(B) amended Code Sec. 4978(a) by inserting "or acquired any qualified employer securities in a qualified gratuitous transfer to which section 664(g) applied" after "section 1042 applied", and by inserting before the comma at the end of paragraph (2) "60 percent of the total value of all employer securities as of such disposition in the case of any qualified employer securities acquired in a qualified gratuitous transfer to which section 664(g) applied)".

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

(b) AMOUNT OF TAX.—

* * *

(2) LIMITATION.—The amount realized taken into account under paragraph (1) shall not exceed that portion allocable to qualified securities acquired in the sale to which section 1042 applied *or acquired in the qualified gratuitous transfer to which section 664(g) applied* determined as if such securities were disposed of—

(A) first from qualified securities to which section 1042 applied *or to which section 664(g) applied* acquired during the 3-year period ending on the date of the disposition, beginning with the securities first so acquired, and

(B) then from any other employer securities.

* * *

Amendment Notes

Act Sec. 1530(c)(12)(A)-(B) amended Code Sec. 4978(b)(2) by inserting "or acquired in the qualified gratuitous transfer to which section 664(g) applied" after "section 1042 applied", and by inserting "or to which section 664(g) applied" after "section 1042 applied" in subparagraph (A) thereof.

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

(c) LIABILITY FOR PAYMENT OF TAXES.—The tax imposed by this subsection shall be paid by—

(1) the employer, or

(2) the eligible worker-owned cooperative,

that made the *written statement described in section 664(g)(1)(E) or in section 1042(b)(3) (as the case may be).*

* * *

Amendment Notes

Act Sec. 1530(c)(13) amended Code Sec. 4978(c) by striking "written statement" and all that follows and inserting "written statement described in section 664(g)(1)(E) or in section 1042(b)(3) (as the case may be)." Prior to amendment, Code Sec. 4978(c) read as follows:

(c) LIABILITY FOR PAYMENT OF TAXES.—The tax imposed by this subsection shall be paid by—

(1) the employer, or

(2) the eligible worker-owned cooperative,

that made the written statement described in section 1042(b)(3).

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

* * *

(2) QUALIFIED SECURITIES.—The term "qualified securities" has the meaning given to such term by section 1042(c)(1)*; except that such section shall be applied without regard to subparagraph (B) thereof for purposes of applying this section and section 4979A with respect to securities acquired in a qualified gratuitous transfer (as defined in section 664(g)(1)).*

* * *

[CCH Explanation at ¶ 284. Committee Reports at ¶ 13,435.]

Amendment Notes

Act Sec. 1530(c)(14) amended Code Sec. 4978(e)(2) by striking the period and inserting "; except that such section shall be applied without regard to subparagraph (B) thereof for purposes of applying this section and section 4979A with respect to securities acquired in a qualified gratuitous transfer (as defined in section 664(g)(1))."

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

[¶ 5533] CODE SEC. 4979A. TAX ON CERTAIN PROHIBITED ALLOCATIONS OF QUALIFIED SECURITIES.

(a) IMPOSITION OF TAX.—If—

(1) there is a prohibited allocation of qualified securities by any employee stock ownership plan or eligible worker-owned cooperative, or

(2) there is an allocation described in section 664(g)(5)(A),

there is hereby imposed a tax on such allocation equal to 50 percent of the amount involved.

* * *

Amendment Notes

Act Sec. 1530(c)(15) amended Code Sec. 4979A(a) to read as above. Prior to amendment, Code Sec. 4979A(a) read as follows:

(a) IMPOSITION OF TAX.—If there is a prohibited allocation of qualified securities by any employee stock ownership plan or eligible worker-owned cooperative, there is hereby imposed a tax on such allocation equal to 50 percent of the amount involved.

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

(c) LIABILITY FOR TAX.—The tax imposed by this section shall be paid by—

(1) the employer sponsoring such plan, or

(2) the eligible worker-owned cooperative,

which made the written statement described in section 664(g)(1)(E) or in section 1042(b)(3)(B) (as the case may be).

Amendment Notes

Act Sec. 1530(c)(16) amended Code Sec. 4979A(c) to read as above. Prior to amendment, Code Sec. 4979A(c) read as follows:

(c) LIABILITY FOR TAX.—The tax imposed by this section shall be paid by—

(1) the employer sponsoring such plan, or

(2) the eligible worker-owned cooperative, which made the written statement described in section 1042(b)(3)(B).

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

(d) SPECIAL STATUTE OF LIMITATIONS FOR TAX ATTRIBUTABLE TO CERTAIN ALLOCATIONS.—The statutory period for the assessment of any tax imposed by this section on an allocation described in subsection (a)(2) of qualified employer securities shall not expire before the date which is 3 years from the later of—

(1) the 1st allocation of such securities in connection with a qualified gratuitous transfer (as defined in section 664(g)(1)), or

(2) the date on which the Secretary is notified of the allocation described in subsection (a)(2).

Amendment Notes

Act Sec. 1530(c)(17) amended Code Sec. 4979A by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) a new subsection (d) to read as above.

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

(e) DEFINITIONS.—Terms used in this section have the same respective meaning as when used in section 4978.

* * *

[CCH Explanation at ¶ 284. Committee Reports at ¶ 13,435.]

Amendment Notes

Act Sec. 1530(c)(17) amended Code Sec. 4979A by redesignating subsection (d) as subsection (e).

The above amendment applies to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

[¶ 5535] CODE SEC. 4980A. TAX ON EXCESS DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS. *[REPEALED.]*

[CCH Explanation at ¶ 714. Committee Reports at ¶ 11,465.]

Amendment Notes

Act Sec. 1073(a) repealed Code Sec. 4980A. Prior to repeal, Code Sec. 4980A read as follows:

SEC. 4980A. TAX ON EXCESS DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS.

(a) GENERAL RULE.—There is hereby imposed a tax equal to 15 percent of the excess distributions with respect to any individual during any calendar year.

(b) LIABILITY FOR TAX.—The individual with respect to whom the excess distributions are made shall be liable for the tax imposed by subsection (a). The amount of the tax

imposed by subsection (a) shall be reduced by the amount (if any) of the tax imposed by section 72(t) to the extent attributable to such excess distributions.

(c) EXCESS DISTRIBUTIONS.—For purposes of this section—

(1) IN GENERAL.—The term "excess distributions" means the aggregate amount of the retirement distributions with respect to any individual during any calendar year to the extent such amount exceeds the greater of—

(A) $150,000, or

(B) $112,500 (adjusted at the same time and in the same manner as under section 415(d)).

(2) EXCLUSION OF CERTAIN DISTRIBUTIONS.—The following distributions shall not be taken into account under paragraph (1):

(A) Any retirement distribution with respect to an individual made after the death of such individual.

(B) Any retirement distribution with respect to an individual payable to an alternate payee pursuant to a qualified domestic relations order (within the meaning of section 414(p)) if includible in income of the alternate payee.

(C) Any retirement distribution with respect to an individual which is attributable to the individual's investment in the contract (as defined in section 72(f)).

(D) Any retirement distribution to the extent not included in gross income by reason of a rollover contribution.

(E) Any retirement distribution with respect to an individual of an annuity contract the value of which is not includible in gross income at the time of the distribution (other than distributions under, or proceeds from the sale or exchange of, such contract).

(F) Any retirement distribution with respect to an individual of—

(i) excess deferrals (and income allocable thereto) under section 402(g)(2)(A)(ii), or

(ii) excess contributions (and income allocable thereto) under section 401(k)(8) or 408(d)(4) or excess aggregate contributions (and income allocable thereto) under section 401(m)(6).

Any distribution described in subparagraph (B) shall be treated as a retirement distribution to the person to whom paid for purposes of this section.

(3) AGGREGATION OF PAYMENTS.—If retirement distributions with respect to any individual during any calendar year are received by the individual and 1 or more other persons, all such distributions shall be aggregated for purposes of determining the amount of the excess distributions for the calendar year.

(4) SPECIAL ONE-TIME ELECTION.—If the retirement distributions with respect to any individual during any calendar year include a lump sum distribution (as defined in section 402(e)(4)(D)) with respect to which the individual elects to have this paragraph apply—

(A) paragraph (1) shall be applied separately with respect to such lump sum distribution and other retirement distributions, and

(B) the limitation under paragraph (1) with respect to such lump sum distribution shall be equal to 5 times the amount of such limitation determined without regard to this subparagraph.

An individual may elect to have this paragraph apply to only one lump-sum distribution.

(d) INCREASE IN ESTATE TAX IF INDIVIDUAL DIES WITH EXCESS ACCUMULATION.—

(1) IN GENERAL.—The tax imposed by chapter 11 with respect to the estate of any individual shall be increased by an amount equal to 15 percent of the individual's excess retirement accumulation.

(2) NO CREDIT ALLOWABLE.—No credit shall be allowable under chapter 11 with respect to any portion of the tax imposed by chapter 11 attributable to the increase under paragraph (1).

(3) EXCESS RETIREMENT ACCUMULATION.—For purposes of paragraph (1), the term "excess retirement accumulation" means the excess (if any) of—

(A) the value of the individual's interests (other than as beneficiary, determined after application of paragraph (5)) in qualified employer plans and individual retirement plans as of the date of the decedent's death (or, in the case of an election under section 2032, the applicable valuation date prescribed by such section), over

(B) the present value (as determined under rules prescribed by the Secretary as of the valuation date prescribed in subparagraph (A)) of a single life annuity with annual payments equal to the limitation of subsection (c) (as in effect for the year in which death occurs and as if the individual had not died).

(4) RULES FOR COMPUTING EXCESS RETIREMENT ACCUMULATION.—The excess retirement accumulation of an indiviudal shall be computed without regard to—

(A) any community property law,

(B) the value of—

(i) amounts payable to an alternate payee pursuant to a qualified domestic relations order (within the meaning of section 414(p)) if includible in income of the alternate payee, and

(ii) the individual's investment in the contract (as defined in section 72(f)), and

(C) the excess (if any) of—

(i) any interests which are payable immediately after death, over

(ii) the value of such interests immediately before death.

(5) ELECTION BY SPOUSE TO HAVE EXCESS DISTRIBUTION RULE APPLY.—

(A) IN GENERAL.—If the spouse of an individual is the beneficiary of all of the interests described in paragraph (3)(A), the spouse may elect—

(i) not to have this subsection apply, and

(ii) to have this section apply to such interests and any retirement distribution attributable to such interests as if such interests were the spouse's.

(B) DE MINIMIS EXCEPTION.—If 1 or more persons other than the spouse are beneficiaries of a de minimis portion of the interests described in paragraph (3)(A)—

(i) the spouse shall not be treated as failing to meet the requirements of subparagraph (A), and

(ii) if the spouse makes the election under subparagraph (A), this section shall not apply to such portion or any retirement distribution attributable to such portion.

(e) RETIREMENT DISTRIBUTIONS.—For purposes of this section—

(1) IN GENERAL.—The term "retirement distribution" means, with respect to any individual, the amount distributed during the taxable year under—

(A) any qualified employer plan with respect to which such individual is or was the employee, and

(B) any individual retirement plan.

(2) QUALIFIED EMPLOYER PLAN.—The term "qualified employer plan" means—

(A) any plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

(B) an annuity plan described in section 403(a), or

(C) an annuity contract described in section 403(b).

Such term includes any plan or contract which, at any time, has been determined by the Secretary to be such a plan or contract.

(f) EXEMPTION OF ACCRUED BENEFITS IN EXCESS OF $562,500 ON AUGUST 1, 1986.—For purposes of this section—

(1) IN GENERAL.—If an election is made with respect to an eligible individual to have this subsection apply, the individual's excess distributions and excess retirement accumulation shall be computed without regard to any distributions or

interests attributable to the accrued benefit of the individual as of August 1, 1986.

(2) REDUCTION IN AMOUNTS WHICH MAY BE RECEIVED WITHOUT TAX.—If this subsection applies to any individual—

(A) EXCESS DISTRIBUTIONS.—Subsection (c)(1) shall be applied—

(i) without regard to subparagraph (A), and

(ii) by reducing (but not below zero) the amount determined under subparagraph (B) thereof by retirement distributions attributable (as determined under rules prescribed by the Secretary) to the individual's accrued benefit as of August 1, 1986.

(B) EXCESS RETIREMENT ACCUMULATION.—The amount determined under subsection (d)(3)(B) (without regard to subsection (c)(1)(A)) with respect to such individual shall be reduced (but not below zero) by the present value of the individual's accrued benefit as of August 1, 1986, which has not been distributed as of the date of death.

(3) ELIGIBLE INDIVIDUAL.—For purposes of this subsection, the term "eligible individual" means any individual if, on August 1, 1986, the present value of such individual's interest in qualified employer plans and individual retirement plans exceeded $562,500.

(4) CERTAIN AMOUNTS EXCLUDED.—In determining an individual's accrued benefit for purposes of this subsection, there shall not be taken into account any portion of the accrued benefit—

(A) payable to an alternate payee pursuant to a qualified domestic relations order (within the meaning of section 414(p)) if includible in income of the alternate payee, or

(B) attributable to the individual's investment in the contract (as defined in section 72(f)).

(5) ELECTION.—An election under paragraph (1) shall be made on an individual's return of tax imposed by chapter 1 or 11 for a taxable year beginning before January 1, 1989.

(g) LIMITATION ON APPLICATION.—This section shall not apply to distributions during years beginning after December 31, 1996, and before January 1, 2000, and such distributions shall be treated as made first from amounts not described in subsection (f).

The above amendment generally applies to excess distributions received after December 31, 1996. For a special rule, see Act Sec. 1073(c)(2), below.

Act Sec. 1073(c)(2) provides:

(2) EXCESS RETIREMENT ACCUMULATION TAX REPEAL.—The repeal made by subsection (a) with respect to section 4980A(d) of the Internal Revenue Code of 1986 and the amendments made by subsection (b) shall apply to estates of decedents dying after December 31, 1996.

[¶ 5537] CODE SEC. 4980D. FAILURE TO MEET CERTAIN GROUP HEALTH PLAN REQUIREMENTS.

(a) GENERAL RULE.—There is hereby imposed a tax on any failure of a group health plan to meet the requirements of chapter 100 (relating to group health *plans* requirements).

* * *

Amendment Notes

Act Sec. 1531(b)(2)(A) amended Code Sec. 4980D(a) by striking "plan portability, access, and renewability" and inserting "plans".

The above amendment applies with respect to group health plans for plan years beginning on or after January 1, 1998.

(c) LIMITATIONS ON AMOUNT OF TAX.—

* * *

(3) OVERALL LIMITATION FOR UNINTENTIONAL FAILURES.—In the case of failures which are due to reasonable cause and not to willful neglect—

* * *

(B) SPECIFIED MULTIPLE EMPLOYER HEALTH PLANS.—

(i) IN GENERAL.—In the case of failures with respect to a specified multiple employer health plan, the tax imposed by subsection (a) for failures during the taxable year of the trust forming part of such plan shall not exceed the amount equal to the lesser of—

(I) 10 percent of the amount paid or incurred by such trust during such taxable year to provide medical care (as defined in section *9832(d)(3)*) directly or through insurance, reimbursement, or otherwise, or

(II) $500,000.

For purposes of the preceding sentence, all plans of which the same trust forms a part shall be treated as 1 plan.

* * *

Amendment Notes

Act Sec. 1531(b)(2)(B) amended Code Sec. 4980D(c)(3)(B)(i)(I) by striking "9805(d)(3)" and inserting "9832(d)(3)".

The above amendment applies with respect to group health plans for plan years beginning on or after January 1, 1998.

(d) TAX NOT TO APPLY TO CERTAIN INSURED SMALL EMPLOYER PLANS.—

(1) IN GENERAL.—In the case of a group health plan of a small employer which provides health insurance coverage solely through a contract with a health insurance issuer, no tax shall be imposed by this section on the employer on any failure *(other than a failure attributable to section 9811)* which is solely because of the health insurance coverage offered by such issuer.

* * *

(3) HEALTH INSURANCE COVERAGE; HEALTH INSURANCE ISSUER.—For purposes of paragraph (1), the terms "health insurance coverage" and "health insurance issuer" have the respective meanings given such terms by section *9832.*

* * *

Amendment Notes

Act Sec. 1531(b)(2)(C) amended Code Sec. 4980D(d)(1) by inserting "(other than a failure attributable to section 9811)" after "on any failure".

Act Sec. 1531(b)(2)(D) amended Code Sec. 4980D(d)(3) by striking "9805" and inserting "9832".

The above amendments apply with respect to group health plans for plan years beginning on or after January 1, 1998.

(f) DEFINITIONS.—For purposes of this section—

(1) GROUP HEALTH PLAN.—The term "group health plan" has the meaning given such term by section *9832(a).*

* * *

[CCH Explanation at ¶ 865. Committee Reports at ¶ 13,455.]

Amendment Notes

Act Sec. 1531(b)(2)(E) amended Code Sec. 4980D(f)(1) by striking "9805(a)" and inserting "9832(a)".

The above amendment applies with respect to group health plans for plan years beginning on or after January 1, 1998.

[¶ 5539] CODE SEC. 4982. EXCISE TAX ON UNDISTRIBUTED INCOME OF REGULATED INVESTMENT COMPANIES.

* * *

(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

* * *

(6) TREATMENT OF GAIN RECOGNIZED UNDER SECTION 1296.—For purposes of determining a regulated investment company's ordinary income—

(A) notwithstanding paragraph (1)(C), section 1296 shall be applied as if such company's taxable year ended on October 31, and

(B) any ordinary gain or loss from an actual disposition of stock in a passive foreign investment company during the portion of the calendar year after October 31 shall be taken into account in determining such regulated investment company's ordinary income for the following calendar year.

In the case of a company making an election under paragraph (4), the preceding sentence shall be applied by substituting the last day of the company's taxable year for October 31.

* * *

[CCH Explanation at ¶ 946. Committee Reports at ¶ 11,690.]

Amendment Notes

Act Sec. 1122(c)(1) amended Code Sec. 4982(e) by adding at the end thereof a new paragraph (6) to read as above.

The above amendment applies to tax years of United States persons beginning after December 31, 1997, and tax years of foreign corporations ending with or within such tax years of United States persons.

[¶ 5541] CODE SEC. 5008. ABATEMENT, REMISSION, REFUND, AND ALLOWANCE FOR LOSS OR DESTRUCTION OF DISTILLED SPIRITS.

* * *

(c) DISTILLED SPIRITS RETURNED TO BONDED PREMISES.—

[Caution: Code Sec. 5008(c)(1), below, as amended by Act Sec. 1411(a) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.]

(1) IN GENERAL.—Whenever any distilled spirits *on which tax has been determined or paid* are returned to the bonded premises of a distilled spirits plant under section 5215(a), the Secretary shall abate or (without interest) credit or refund the tax imposed under section 5001(a)(1) (or the tax equal to such tax imposed under section 7652) on the spirits so returned.

* * *

[CCH Explanation at ¶ 1271. Committee Reports at ¶ 12,755.]

Amendment Notes

Act Sec. 1411(a) amended Code Sec. 5008(c)(1) by striking "withdrawn from bonded premises on payment or determination of tax" and inserting "on which tax has been determined or paid".

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[¶ 5543] CODE SEC. 5041. IMPOSITION AND RATE OF TAX.

* * *

(b) RATES OF TAX.—

(1) On still wines containing not more than 14 percent of alcohol by volume, $1.07 per wine gallon;

(2) On still wines containing more than 14 percent and not exceeding 21 percent of alcohol by volume, $1.57 per wine gallon;

(3) On still wines containing more than 21 percent and not exceeding 24 percent of alcohol by volume, $3.15 per wine gallon;

(4) On champagne and other sparkling wines, $3.40 per wine gallon;

(5) On artificially carbonated wines, $3.30 per wine gallon*; and*

(6) On hard cider derived primarily from apples or apple concentrate and water, containing no other fruit product, and containing at least one-half of 1 percent and less than 7 percent alcohol by volume, 22.6 cents per wine gallon.

Amendment Notes

Act Sec. 908(a) amended Code Sec. 5041(b) by striking "and" at the end of paragraph (4), by striking the period at the end of paragraph (5) and inserting "; and", and by adding at the end a new paragraph (6) to read as above.

The above amendment is effective on October 1, 1997.

(c) CREDIT FOR SMALL DOMESTIC PRODUCERS.—

(1) ALLOWANCE OF CREDIT.—Except as provided in paragraph (2), in the case of a person who produces not more than 250,000 wine gallons of wine during the calendar year, there shall be allowed as a credit against any tax imposed by this title (other than chapters 2, 21, and 22) of 90 cents per wine gallon on the 1st 100,000 wine gallons of wine (other than wine described in subsection (b)(4)) which are removed during such year for consumption or sale and which have been produced at qualified facilities in the United States. *In the case of wine described in subsection (b)(6), the preceding sentence shall be applied by substituting "5.6 cents" for "90 cents".*

* * *

[CCH Explanation at ¶ 1276. Committee Reports at ¶ 10,550.]

Amendment Notes

Act Sec. 908(b) amended Code Sec. 5041(c)(1) by adding at the end a new sentence to read as above.

The above amendment is effective on October 1, 1997.

[*Caution: Code Sec. 5044, below, as amended by Act Sec. 1416(a) and (b)(2) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.*]

[¶ 5545] CODE SEC. 5044. REFUND OF TAX ON WINE.

(a) GENERAL.—In the case of any wine produced in the United States and returned to bond under section 5361—

(1) any tax imposed by section 5041 shall, if paid, be refunded or credited, without interest, to the proprietor of the bonded wine cellar to which such wine is delivered; or

(2) if any tax so imposed has not been paid, the person liable for the tax may be relieved of liability therefor,

under such regulations as the Secretary may prescribe. Such regulations may provide that claim for refund or credit under paragraph (1), or relief from liability under paragraph (2), may be made only with respect to minimum quantities specified in such regulations. The burden of proof in all such cases shall be on the applicant.

* * *

[CCH Explanation at ¶ 1280. Committee Reports at ¶ 12,780.]

Amendment Notes

Act Sec. 1416(a) amended Code Sec. 5044(a) by striking "as unmerchantable" after "returned to bond".

Act Sec. 1416(b)(2) amended Code Sec. 5044 by striking "**UNMERCHANTABLE**" before "**WINE**" in the section heading.

The above amendments are effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[¶ 5547] CODE SEC. 5053. EXEMPTIONS.

* * *

[*Caution: Code Sec. 5053(f), below, as added by Act Sec. 1414(b) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.*]

(f) Removal For Use as Distilling Material.—Subject to such regulations as the Secretary may prescribe, beer may be removed from a brewery without payment of tax to any distilled spirits plant for use as distilling material.

Amendment Notes

Act Sec. 1414(b) amended Code Sec. 5053 by redesignating subsection (f) as subsection (i) and by inserting after subsection (e) a new subsection (f) to read as above.

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[*Caution: Code Sec. 5053(g), below, as added by Act Sec. 1418(a) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.*]

(g) Removals For Use of Foreign Embassies, Legations, etc.—

(1) In general.—Subject to such regulations as the Secretary may prescribe—

(A) beer may be withdrawn from the brewery without payment of tax for transfer to any customs bonded warehouse for entry pending withdrawal therefrom as provided in subparagraph (B), and

(B) beer entered into any customs bonded warehouse under subparagraph (A) may be withdrawn for consumption in the United States by, and for the official and family use of, such foreign governments, organizations, and individuals as are entitled to withdraw imported beer from such warehouses free of tax.

Beer transferred to any customs bonded warehouse under subparagraph (A) shall be entered, stored, and accounted for in such warehouse under such regulations and bonds as the Secretary may prescribe, and may be withdrawn therefrom by such governments, organizations, and individuals free of tax under the same conditions and procedures as imported beer.

(2) Other rules to apply.—Rules similar to the rules of paragraphs (2) and (3) of section 5362(e) shall apply for purposes of this subsection.

Amendment Notes

Act Sec. 1418(a) amended Code Sec. 5053, as amended by Act Sec. 1414(b), by inserting after subsection (f) a new subsection (g) to read as above.

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[*Caution: Code Sec. 5053(h), below, as added by Act Sec. 1419(a) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.*]

(h) REMOVALS FOR DESTRUCTION.—Subject to such regulations as the Secretary may prescribe, beer may be removed from the brewery without payment of tax for destruction.

Amendment Notes

Act Sec. 1419(a) amended Code Sec. 5053, as amended by Act Sec. 1418(a), by inserting after subsection (g) a new subsection (h) to read as above.

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[*Caution: Code Sec. 5053(i), below, as redesignated by Act Sec. 1414(b) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.*]

(i) REMOVAL AS SUPPLIES FOR CERTAIN VESSELS AND AIRCRAFT.—

For exemption as to supplies for certain vessels and aircraft, see section 309 of the Tariff Act of 1930, as amended (19 U.S.C. 1309).

* * *

[CCH Explanation at ¶ 1274, 1285 and 1286. Committee Reports at ¶ 12,770, 12,790 and 12,795.]

Amendment Notes

Act Sec. 1414(b) amended Code Sec. 5053 by redesignating subsection (f) as subsection (i).

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[*Caution: Code Sec. 5055, below, as amended by Act Sec. 1420(a) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.*]

[¶ 5549] CODE SEC. 5055. DRAWBACK OF TAX.

On the exportation of beer, brewed or produced in the United States, the brewer thereof shall be allowed a drawback equal in amount to the tax *paid on such beer if there is such proof of exportation as the Secretary may by regulations require.* For the purpose of this section, exportation shall include delivery for use as supplies on the vessels and aircraft described in section 309 of the Tariff Act of 1930, as amended (19 U. S. C. 1309).

[CCH Explanation at ¶ 1287. Committee Reports at ¶ 12,815.]

Amendment Notes

Act Sec. 1420(a) amended Code Sec. 5055 by striking "found to have been paid" and all that follows in the first sentence and inserting "paid on such beer if there is such proof of exportation as the Secretary may by regulations require.". Prior to amendment, Code Sec. 5055 read as follows:

SEC. 5055. DRAWBACK OF TAX.

On the exportation of beer, brewed or produced in the United States, the brewer thereof shall be allowed a drawback equal in amount to the tax found to have been paid on such beer, to be paid on submission of such evidence, records and certificates indicating exportation, as the Secretary may by regulations prescribe. For the purpose of this section, exportation shall include delivery for use as supplies on the vessels and aircraft described in section 309 of the Tariff Act of 1930, as amended (19 U. S. C. 1309).

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[¶ 5551] CODE SEC. 5056. REFUND AND CREDIT OF TAX, OR RELIEF FROM LIABILITY.

* * *

[*Caution: Code Sec. 5056(c), below, as added by Act Sec. 1414(c)(1) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.*]

(c) BEER RECEIVED AT A DISTILLED SPIRITS PLANT.—Any tax paid by any brewer on beer produced in the United States may be refunded or credited to the brewer, without interest, or if the tax has not been paid, the brewer may be relieved of liability therefor, under regulations as the Secretary may prescribe, if such beer is received on the bonded premises of a distilled spirits plant pursuant to the provisions of section 5222(b)(2), for use in the production of distilled spirits.

Amendment Notes

Act Sec. 1414(c)(1) amended Code Sec. 5056 by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) a new subsection (c) to read as above.

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[Caution: Code Sec. 5056(d), below, as amended by Act Sec. 1414(c)(1)-(2) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.]

(d) LIMITATIONS.—No claim under this section shall be allowed (1) unless filed within 6 months after the date of the return, loss, destruction, *rendering unmerchantable, or receipt on the bonded premises of a distilled spirits plant* or (2) if the claimant was indemnified by insurance or otherwise in respect of the tax.

* * *

[CCH Explanation at ¶ 1274. Committee Reports at ¶ 12,770.]

Amendment Notes

Act Sec. 1414(c)(1)-(2) amended Code Sec. 5056 by redesignating subsection (c) as subsection (d), and by striking "or rendering unmerchantable" in subsection (d) (as so redesignated) and inserting "rendering unmerchantable, or receipt on the bonded premises of a distilled spirits plant".

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[¶ 5553] CODE SEC. 5115. SIGN REQUIRED ON PREMISES. *[REPEALED.]*

* * *

[CCH Explanation at ¶ 1275. Committee Reports at ¶ 12,775.]

Amendment Notes

Act Sec. 1415(a) repealed Code Sec. 5115. Prior to repeal, Code Sec. 5115 read as follows:

SEC. 5115. SIGN REQUIRED ON PREMISES.

(a) REQUIREMENTS.—Every wholesale dealer in liquors who is required to pay special tax as such dealer shall, in the manner and form prescribed by regulations issued by the Secretary, place and keep conspicuously on the outside of the place of such business a sign, exhibiting, in plain and legible letters, the name or firm of the wholesale dealer, with the words: "wholesale liquor dealer". The requirements of this subsection will be met by the posting of a sign of the character prescribed herein, but with words conforming to the designation on the dealer's special tax stamp.

(b) PENALTY.—

For penalty for failure to post sign, or for posting sign without paying the special tax, see section 5681.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5555] CODE SEC. 5175. EXPORT BONDS.

* * *

[Caution: Code Sec. 5175(c), below, as amended by Act Sec. 1412(a) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.]

(c) CANCELLATION OR CREDIT OF EXPORT BONDS.—The bonds given under subsection (a) shall be cancelled or credited and the bonds liable under subsection (b) credited *if there is such proof of exportation as the Secretary may by regulations require.*

* * *

[CCH Explanation at ¶ 1272. Committee Reports at ¶ 12,760.]

Amendment Notes

Act Sec. 1412(a) amended Code Sec. 5175(c) by striking "on the submission of" and all that follows and inserting "if there is such proof of exportation as the Secretary may by regulations require.". Prior to amendment, Code Sec. 5175(c) read as follows:

(c) CANCELLATION OR CREDIT OF EXPORT BONDS.—The bonds given under subsection (a) shall be cancelled or credited and the bonds liable under subsection (b) credited on the submission of such evidence, records, and certification indicating exportation as the Secretary may by regulations prescribe.

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[¶ 5557] CODE SEC. 5207. RECORDS AND REPORTS.

* * *

[Caution: Code Sec. 5207(c), below, as amended by Act Sec. 1413(a) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.]

(c) PRESERVATION AND INSPECTION.—The records required by subsection (a) and a copy of each report required by subsection (b) shall be available for inspection by any internal revenue officer during business hours, and shall be preserved by the person required to keep such records and reports for such period as the Secretary shall by regulations prescribe.

* * *

[CCH Explanation at ¶ 1273. Committee Reports at ¶ 12,765.]

Amendment Notes

Act Sec. 1413(a) amended Code Sec. 5207(c) by striking "shall be kept on the premises where the operations covered by the record are carried on and" after "subsection (b)".

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[¶ 5559] CODE SEC. 5222. PRODUCTION, RECEIPT, REMOVAL, AND USE OF DISTILLING MATERIALS.

* * *

(b) RECEIPT.—Under such regulations as the Secretary may prescribe, fermented materials to be used in the production of distilled spirits may be received on the bonded premises of a distilled spirits plant authorized to produce distilled spirits as follows—

* * *

[Caution: Code Sec. 5222(b)(2), below, as amended by Act Sec. 1414(a) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.]

(2) beer conveyed without payment of tax from brewery premises, beer which has been lawfully removed from brewery premises upon determination of tax, or

* * *

[CCH Explanation at ¶ 1274. Committee Reports at ¶ 12,770.]

Amendment Notes

Act Sec. 1414(a) amended Code Sec. 5222(b)(2) to read as above. Prior to amendment, Code Sec. 5222(b)(2) read as follows:

(2) conveyed without payment of tax from contiguous brewery premises where produced; or

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[Caution: Code Sec. 5361, below, as amended by Act Sec. 1416(b)(1) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.]

[¶ 5561] CODE SEC. 5361. BONDED WINE CELLAR OPERATIONS.

In addition to the operations described in section 5351, the proprietor of a bonded wine cellar may, subject to regulations prescribed by the Secretary, on such premises receive taxpaid wine for return to bond, reconditioning, or destruction; prepare for market and store commercial fruit products and by-products not taxable as wines; produce or receive distilling material or vinegar stock; produce (with or without added wine spirits, and without added sugar) or receive on wine premises, subject to tax as wine but not for sale or consumption as beverage wine, (1) heavy bodied blending wines and Spanish-type blending sherries, and (2) other wine products made from natural wine for nonbeverage purposes; and such other operations as may be conducted in a manner that will not jeopardize the revenue or conflict with wine operations.

* * *

[CCH Explanation at ¶ 1280. Committee Reports at ¶ 12,780.]

Amendment Notes

Act Sec. 1416(b)(1) amended Code Sec. 5361 by striking "unmerchantable" after "on such premises receive".

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[Caution: Code Sec. 5364, below, as added by Act Sec. 1422(a) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.]

[¶ 5563] *CODE SEC. 5364. WINE IMPORTED IN BULK.*

Wine imported or brought into the United States in bulk containers may, under such regulations as the Secretary may prescribe, be withdrawn from customs custody and transferred in such bulk containers to the premises of a bonded wine cellar without payment of the internal revenue tax imposed on such wine. The proprietor of a bonded wine cellar to which such wine is transferred shall become liable for the tax on the wine withdrawn from customs custody under this section upon release of the wine from customs custody, and the importer, or the person bringing such wine into the United States, shall thereupon be relieved of the liability for such tax.

* * *

[CCH Explanation at ¶ 1282. Committee Reports at ¶ 12,825.]

Amendment Notes

Act Sec. 1422(a) amended part II of subchapter F of chapter 51 by inserting after Code Sec. 5363 a new Code Sec. 5364 to read as above.

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[¶ 5565] CODE SEC. 5384. AMELIORATION AND SWEETENING LIMITATIONS FOR NATURAL FRUIT AND BERRY WINES.

* * *

(b) AMELIORATED FRUIT AND BERRY WINES.—

* * *

(2) Pure dry sugar or liquid sugar may be used in the production of wines under this subsection for the purpose of correcting natural deficiencies, but not to such an extent as would reduce the natural fixed acid in the corrected juice or wine to five parts per thousand. The quantity of sugar so used shall not exceed the quantity which would have been required to adjust the juice, prior to fermentation, to a total solids content of 25 degrees (Brix). Such sugar shall be added prior to the completion of fermentation of the wine. After such addition of the sugar, the wine or juice shall be treated and accounted for as provided in section 5383(b), covering the production of high acid grape wines, except that—

* * *

[Caution: Code Sec. 5384(b)(2)(D), below, as amended by Act Sec. 1417(a) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.]

(D) Wines made exclusively from *any fruit or berry with a natural fixed acid of 20 parts per thousand or more (before any correction of such fruit or berry)* shall be entitled to a volume of ameliorating material not in excess of 60 percent (in lieu of 35 percent).

* * *

[CCH Explanation at ¶ 1281. Committee Reports at ¶ 12,785.]

Amendment Notes

Act Sec. 1417(a) amended Code Sec. 5384(b)(2)(D) by striking "loganberries, currants, or gooseberries," and inserting "any fruit or berry with a natural fixed acid of 20 parts per thousand or more (before any correction of such fruit or berry)".

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[¶ 5567] CODE SEC. 5388. DESIGNATION OF WINES.

* * *

(c) USE OF SEMI-GENERIC DESIGNATIONS.—

(1) IN GENERAL.—Semi-generic designations may be used to designate wines of an origin other than that indicated by such name only if—

(A) there appears in direct conjunction therewith an appropriate appellation of origin disclosing the true place of origin of the wine, and

(B) the wine so designated conforms to the standard of identity, if any, for such wine contained in the regulations under this section or, if there is no such standard, to the trade understanding of such class or type.

(2) DETERMINATION OF WHETHER NAME IS SEMI-GENERIC.—

(A) IN GENERAL.—Except as provided in subparagraph (B), a name of geographic significance, which is also the designation of a class or type of wine, shall be deemed to have become semi-generic only if so found by the Secretary.

(B) CERTAIN NAMES TREATED AS SEMI-GENERIC.—The following names shall be treated as semi-generic: Angelica, Burgundy, Claret, Chablis, Champagne, Chianti, Malaga, Marsala, Madeira, Moselle, Port, Rhine Wine or Hock, Sauterne, Haut Sauterne, Sherry, Tokay.

* * *

[CCH Explanation at ¶ 1283. Committee Reports at ¶ 10,560.]

Amendment Notes

Act Sec. 910(a) amended Code Sec. 5388 by adding at the end a new subsection (c) to read as above.

The above amendment is effective on the date of the enactment of this Act.

[Caution: Code Sec. 5418, below, as added by Act Sec. 1421(a) of the Taxpayer Relief Act of 1997, is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of the Act.—CCH.]

[¶ 5569] *CODE SEC. 5418. BEER IMPORTED IN BULK.*

Beer imported or brought into the United States in bulk containers may, under such regulations as the Secretary may prescribe, be withdrawn from customs custody and transferred in such bulk containers to the premises of a brewery without payment of the internal revenue tax imposed on such beer. The proprietor of a brewery to which such beer is transferred shall become liable for the tax on the beer withdrawn from customs custody under this section upon release of the beer from customs custody, and the importer, or the person bringing such beer into the United States, shall thereupon be relieved of the liability for such tax.

* * *

[CCH Explanation at ¶ 1288. Committee Reports at ¶ 12,820.]

Amendment Notes

Act Sec. 1421(a) amended part II of subchapter G of chapter 51 by adding at the end a new Code Sec. 5418 to read as above.

The above amendment is effective on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

[¶ 5571] CODE SEC. 5681. PENALTY RELATING TO SIGNS.

(a) FAILURE TO POST REQUIRED SIGN.—Every person engaged in distilled spirits operations who fails to post the sign required by section 5180(a) shall be fined not more than $1,000, or imprisoned not more than 1 year, or both.

* * *

Amendment Notes

Act Sec. 1415(b)(1) amended Code Sec. 5681(a) by striking ", and every wholesale dealer in liquors," after "operations" and by striking "section 5115(a) or" after "required by".

The above amendment is effective on the date of the enactment of this Act.

(c) PREMISES WHERE NO SIGN IS PLACED OR KEPT.—Every person who works in any distilled spirits plant *on which no sign required by* section 5180(a) is placed or kept, and every person who knowingly receives at, or carries or conveys any distilled spirits to or from any such distilled spirits plant *or who* knowingly carries or delivers any grain, molasses, or other raw material to any distilled spirits plant on which such a sign is not placed and kept, shall forfeit all vehicles, aircraft, or vessels used in carrying or conveying such property and shall be fined not more than $1,000, or imprisoned not more than 1 year, or both.

* * *

[CCH Explanation at ¶ 1275. Committee Reports at ¶ 12,775.]

Amendment Notes

Act Sec. 1415(b)(2)(A)-(B) amended Code Sec. 5681(c) by striking "or wholesale liquor establishment, on which no sign required by section 5115(a) or" and inserting "on which no sign required by", and by striking "or wholesale liquor establishment, or who" and inserting "or who".

The above amendment is effective on the date of the enactment of this Act.

[¶ 5572] CODE SEC. 5701. RATE OF TAX.

[Caution: Code Sec. 5701(a), below, as amended by Act Sec. 9302(b)(1)-(2) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(a) CIGARS.—On cigars, manufactured in or imported into the United States, there shall be imposed the following taxes:

(1) SMALL CIGARS.—On cigars, weighing not more than 3 pounds per thousand, *$1.828 cents per thousand ($1.594 cents per thousand on cigars removed during 2000 or 2001),*

(2) LARGE CIGARS.—On cigars weighing more than 3 pounds per thousand, a tax *equal to 20.719 percent (18.063 percent on cigars removed during 2000 or 2001) of the price for which sold but not more than $48.75 per thousand ($42.50 per thousand on cigars removed during 2000 or 2001).*

Cigars not exempt from tax under this chapter which are removed but not intended for sale shall be taxed at the same rate as similar cigars removed for sale.

Amendment Notes

Balanced Budget Act

Act Sec. 9302(b)(1)-(2) amended Code Sec. 5701(a) by striking "$1.125 cents per thousand (93.75 cents per thousand on cigars removed during 1991 or 1992)" in paragraph (1) and inserting "$1.828 cents per thousand ($1.594 cents per thousand on cigars removed during 2000 or 2001)", and by striking "equal to" and all that follows in paragraph (2) and inserting "equal to 20.719 percent (18.063 percent on cigars removed during 2000 or 2001) of the price for which sold but not more than $48.75 per thousand ($42.50 per thousand on cigars removed during 2000 or 2001).". Prior to amendment, Code Sec. 5701(a)(2) read as follows:

(2) LARGE CIGARS.—On cigars weighing more than 3 pounds per thousand, a tax equal to—

(A) 10.625 percent of the price for which sold but not more than $25 per thousand on cigars removed during 1991 or 1992, and

(B) 12.75 percent of the price for which sold but not more than $30 per thousand on cigars removed after 1992.

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2), below.

Act Sec. 9302(i)(2) provides:

(2) TRANSITIONAL RULE.—Any person who—

(A) on the date of the enactment of this Act is engaged in business as a manufacturer of roll-your-own tobacco or as an importer of tobacco products or cigarette papers and tubes, and

(B) before January 1, 2000, submits an application under subchapter B of chapter 52 of such Code to engage in such business,

may, notwithstanding such subchapter B, continue to engage in such business pending final action on such application. Pending such final action, all provisions of such chapter 52 shall apply to such applicant in the same manner and to the same extent as if such applicant were a holder of a permit under such chapter 52 to engage in such business.

Act Sec. 9302(j) provides:

(j) FLOOR STOCKS TAXES.—

(1) IMPOSITION OF TAX.—On tobacco products and cigarette papers and tubes manufactured in or imported into the United States which are removed before any tax increase date, and held on such date for sale by any person, there is hereby imposed a tax in an amount equal to the excess of—

(A) the tax which would be imposed under section 5701 of the Internal Revenue Code of 1986 on the article if the article had been removed on such date, over

(B) the prior tax (if any) imposed under section 5701 of such Code on such article.

(2) AUTHORITY TO EXEMPT CIGARETTES HELD IN VENDING MACHINES.—To the extent provided in regulations prescribed by the Secretary, no tax shall be imposed by paragraph (1) on cigarettes held for retail sale on any tax increase date, by any person in any vending machine. If the Secretary provides

such a benefit with respect to any person, the Secretary may reduce the $500 amount in paragraph (3) with respect to such person.

(3) CREDIT AGAINST TAX.—Each person shall be allowed as a credit against the taxes imposed by paragraph (1) an amount equal to $500. Such credit shall not exceed the amount of taxes imposed by paragraph (1) on any tax increase date, for which such person is liable.

(4) LIABILITY FOR TAX AND METHOD OF PAYMENT.—

(A) LIABILITY FOR TAX.—A person holding cigarettes on any tax increase date, to which any tax imposed by paragraph (1) applies shall be liable for such tax.

(B) METHOD OF PAYMENT.—The tax imposed by paragraph (1) shall be paid in such manner as the Secretary shall prescribe by regulations.

(C) TIME FOR PAYMENT.—The tax imposed by paragraph (1) shall be paid on or before April 1 following any tax increase date.

(5) ARTICLES IN FOREIGN TRADE ZONES.—Notwithstanding the Act of June 18, 1934 (48 Stat. 998, 19 U.S.C. 81a) and any other provision of law, any article which is located in a foreign trade zone on any tax increase date, shall be subject to the tax imposed by paragraph (1) if—

(A) internal revenue taxes have been determined, or customs duties liquidated, with respect to such article before such date pursuant to a request made under the 1st proviso of section 3(a) of such Act, or

(B) such article is held on such date under the supervision of a customs officer pursuant to the 2d proviso of such section 3(a).

(6) DEFINITIONS.—For purposes of this subsection—

(A) IN GENERAL.—Terms used in this subsection which are also used in section 5702 of the Internal Revenue Code of 1986 shall have the respective meanings such terms have in such section, as amended by this Act.

(B) TAX INCREASE DATE.—The term "tax increase date" means January 1, 2000, and January 1, 2002.

(C) SECRETARY.—The term "Secretary" means the Secretary of the Treasury or the Secretary's delegate.

(7) CONTROLLED GROUPS.—Rules similar to the rules of section 5061(e)(3) of such Code shall apply for purposes of this subsection.

(8) OTHER LAWS APPLICABLE.—All provisions of law, including penalties, applicable with respect to the taxes imposed by section 5701 of such Code shall, insofar as applicable and not inconsistent with the provisions of this subsection, apply to the floor stocks taxes imposed by paragraph (1), to the same extent as if such taxes were imposed by such section 5701. The Secretary may treat any person who bore the ultimate burden of the tax imposed by paragraph (1) as the person to whom a credit or refund under such provisions may be allowed or made.

[*Caution: Code Sec. 5701(b), below, as amended by Act Sec. 9302(a)(1)-(2) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.*]

(b) CIGARETTES.—On cigarettes, manufactured in or imported into the United States, there shall be imposed the following taxes:

(1) SMALL CIGARETTES.—On cigarettes, weighing not more than 3 pounds per thousand, *$19.50 per thousand ($17 per thousand on cigarettes removed during 2000 or 2001)*;

(2) LARGE CIGARETTES.—On cigarettes, weighing more than 3 pounds per thousand, *$40.95 per thousand ($35.70 per thousand on cigarettes removed during 2000 or 2001)*; except that, if more than 6½ inches in length, they shall be taxable at the rate prescribed for cigarettes weighing not more than 3 pounds per thousand, counting each 2¾ inches, or fraction thereof, of the length of each as one cigarette.

* * *

Amendment Notes

Balanced Budget Act

Act Sec. 9302(a)(1)-(2) amended Code Sec. 5701(b) by striking "$12 per thousand ($10 per thousand on cigarettes removed during 1991 or 1992)" in paragraph (1) and inserting "$19.50 per thousand ($17 per thousand on cigarettes removed during 2000 or 2001)", and by striking "$25.20 per thousand ($21 per thousand on cigarettes removed during 1991 or 1992)" in paragraph (2) and inserting "$40.95 per thousand ($35.70 per thousand on cigarettes removed during 2000 or 2001)".

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

Act Sec. 9302(k) (as added by Act Sec. 1604(f)(3) of the Taxpayer Relief Act of 1997) provides:

(k) COORDINATION WITH TOBACCO INDUSTRY SETTLEMENT AGREEMENT.—The increase in excise taxes collected as a result of the amendments made by subsections (a), (e), and (g) of this section shall be credited against the total payments made by parties pursuant to Federal legislation implementing the tobacco industry settlement agreement of June 20, 1997.

[*Caution: Code Sec. 5701(c), below, as amended by Act Sec. 9302(c) and (h)(3) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.*]

(c) CIGARETTE PAPERS.—*On cigarette papers,* manufactured in or imported into the United States, there shall be imposed a tax of *1.22 cents (1.06 cents on cigarette papers removed during 2000 or 2001)* for each 50 papers or fractional part thereof; except that, if cigarette papers measure more than 6½ inches in

length, they shall be taxable at the rate prescribed, counting each 2¾ inches, or fraction thereof, of the length of each as one cigarette paper.

Amendment Notes

Balanced Budget Act

Act Sec. 9302(c) amended Code Sec. 5701(c) by striking "0.75 cent (0.625 cent on cigarette papers removed during 1991 or 1992)" and inserting "1.22 cents (1.06 cents on cigarette papers removed during 2000 or 2001)".

Act Sec. 9302(h)(3) amended Code Sec. 5701(c) by striking "On each book or set of cigarette papers containing more than 25 papers," and inserting "On cigarette papers,".

The above amendments generally apply to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[Caution: Code Sec. 5701(d), below, as amended by Act Sec. 9302(d) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(d) CIGARETTE TUBES.—On cigarette tubes, manufactured in or imported into the United States, there shall be imposed a tax of *2.44 cents (2.13 cents on cigarette tubes removed during 2000 or 2001)* for each 50 tubes or fractional part thereof, except that if cigarette tubes measure more than 6½ inches in length, they shall be taxable at the rate prescribed, counting each 2¾ inches, or fraction thereof, of the length of each as one cigarette tube.

Amendment Notes

Balanced Budget Act

Act Sec. 9302(d) amended Code Sec. 5701(d) by striking "1.5 cents (1.25 cents on cigarette tubes removed during 1991 or 1992)" and inserting "2.44 cents (2.13 cents on cigarette tubes removed during 2000 or 2001)".

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[Caution: Code Sec. 5701(e), below, as amended by Act Sec. 9302(e)(1)-(2) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(e) SMOKELESS TOBACCO.—On smokeless tobacco, manufactured in or imported into the United States, there shall be imposed the following taxes:

(1) SNUFF.—On snuff, *58.5 cents (51 cents on snuff removed during 2000 or 2001)* per pound and a proportionate tax at the like rate on all fractional parts of a pound.

(2) CHEWING TOBACCO.—On chewing tobacco, *19.5 cents (17 cents on chewing tobacco removed during 2000 or 2001)* per pound and a proportionate tax at the like rate on all fractional parts of a pound.

Amendment Notes

Balanced Budget Act

Act Sec. 9302(e)(1)-(2) amended Code Sec. 5701(e) by striking "36 cents (30 cents on snuff removed during 1991 or 1992)" in paragraph (1) and inserting "58.5 cents (51 cents on snuff removed during 2000 or 2001)", and by striking "12 cents (10 cents on chewing tobacco removed during 1991 or 1992)" in paragraph (2) and inserting "19.5 cents (17 cents on chewing tobacco removed during 2000 or 2001)".

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

Act Sec. 9302(k) (as added by Act Sec. 1604(f)(3) of the Taxpayer Relief Act of 1997) provides:

(k) COORDINATION WITH TOBACCO INDUSTRY SETTLEMENT AGREEMENT.—The increase in excise taxes collected as a result of the amendments made by subsections (a), (e), and (g) of this section shall be credited against the total payments made by parties pursuant to Federal legislation implementing the tobacco industry settlement agreement of June 20, 1997.

[Caution: Code Sec. 5701(f), below, as amended by Act Sec. 9302(f) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(f) PIPE TOBACCO.—On pipe tobacco, manufactured in or imported into the United States, there shall be imposed a tax of *$1.0969 cents (95.67 cents on pipe tobacco removed during 2000 or 2001)* per pound (and a proportionate tax at the like rate on all fractional parts of a pound).

Amendment Notes

Balanced Budget Act

Act Sec. 9302(f) amended Code Sec. 5701(f) by striking "67.5 cents (56.25 cents on pipe tobacco removed during 1991 or 1992)" and inserting "$1.0969 cents (95.67 cents on pipe tobacco removed during 2000 or 2001)".

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[Caution: Code Sec. 5701(g), below, as added by Act Sec. 9302(g)(1) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(g) Roll-Your-Own Tobacco.—On roll-your-own tobacco, manufactured in or imported into the United States, there shall be imposed a tax of $1.0969 cents (95.67 cents on roll-your-own tobacco removed during 2000 or 2001) per pound (and a proportionate tax at the like rate on all fractional parts of a pound).

Amendment Notes

Balanced Budget Act

Act Sec. 9302(g)(1) amended Code Sec. 5701 by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) a new subsection (g) to read as above.

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

Act Sec. 9302(k) (as added by Act Sec. 1604(f)(3) of the Taxpayer Relief Act of 1997) provides:

(k) Coordination With Tobacco Industry Settlement Agreement.—The increase in excise taxes collected as a result of the amendments made by subsections (a), (e), and (g) of this section shall be credited against the total payments made by parties pursuant to Federal legislation implementing the tobacco industry settlement agreement of June 20, 1997.

[Caution: Code Sec. 5701(h), below, as redesignated by Act Sec. 9302(g)(1) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(h) Imported Tobacco Products and Cigarette Papers and Tubes.—The taxes imposed by this section on tobacco products and cigarette papers and tubes imported into the United States shall be in addition to any import duties imposed on such articles, unless such import duties are imposed in lieu of internal revenue tax.

[CCH Explanation at ¶ 1257. Committee Reports at ¶ 20,085.]

Amendment Notes

Balanced Budget Act

Act Sec. 9302(g)(1) amended Code Sec. 5701 by redesignating subsection (g) as subsection (h).

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

Act Sec. 9302(k) (as added by Act Sec. 1604(f)(3) of the Taxpayer Relief Act of 1997) provides:

(k) Coordination With Tobacco Industry Settlement Agreement.—The increase in excise taxes collected as a result of the amendments made by subsections (a), (e), and (g) of this section shall be credited against the total payments made by parties pursuant to Federal legislation implementing the tobacco industry settlement agreement of June 20, 1997.

[¶ 5572A] CODE SEC. 5702. DEFINITIONS.

* * *

[Caution: Code Sec. 5702(c), below, as amended by Act Sec. 9302(g)(3)(A) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(c) Tobacco Products.—"Tobacco products" means cigars, cigarettes, smokeless tobacco, *pipe tobacco, and roll-your-own tobacco.*

Amendment Notes

Balanced Budget Act

Act Sec. 9302(g)(3)(A) amended Code Sec. 5702(c) by striking "and pipe tobacco" and inserting "pipe tobacco, and roll-your-own tobacco".

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

Act Sec. 9302(k) (as added by Act Sec. 1604(f)(3) of the Taxpayer Relief Act of 1997) provides:

(k) Coordination With Tobacco Industry Settlement Agreement.—The increase in excise taxes collected as a result of the amendments made by subsections (a), (e), and (g) of this section shall be credited against the total payments made by parties pursuant to Federal legislation imple-

menting the tobacco industry settlement agreement of June 20, 1997.

[*Caution: Code Sec. 5702(d), below, as amended by Act Sec. 9302(g)(3)(B)(i)-(ii) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.*]

(d) MANUFACTURER OF TOBACCO PRODUCTS.—"Manufacturer of tobacco products" means any person who manufactures cigars, cigarettes, smokeless tobacco, *pipe tobacco, or roll-your-own tobacco*, except that such term shall not include—

(1) a person who produces cigars, cigarettes, smokeless tobacco, pipe tobacco, or roll-your-own tobacco solely for the person's own personal consumption or use, and

(2) a proprietor of a customs bonded manufacturing warehouse with respect to the operation of such warehouse.

* * *

Amendment Notes

Balanced Budget Act

Act Sec. 9302(g)(3)(B)(i)-(ii) amended Code Sec. 5702(d) by striking "or pipe tobacco" and inserting "pipe tobacco, or roll-your-own tobacco" in the material preceding paragraph (1), and by striking paragraph (1) and inserting a new paragraph (1) to read as above. Prior to being stricken, Code Sec. 5702(d)(1) read as follows:

(1) a person who produces cigars or cigarettes solely for his own personal consumption or use; or

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

Act Sec. 9302(k) (as added by Act Sec. 1604(f)(3) of the Taxpayer Relief Act of 1997) provides:

(k) COORDINATION WITH TOBACCO INDUSTRY SETTLEMENT AGREEMENT.—The increase in excise taxes collected as a result of the amendments made by subsections (a), (e), and (g) of this section shall be credited against the total payments made by parties pursuant to Federal legislation implementing the tobacco industry settlement agreement of June 20, 1997.

[*Caution: Code Sec. 5702(k), below, as amended by Act Sec. 9302(h)(4) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.*]

(k) REMOVAL OR REMOVE.—"Removal" or "remove" means the removal of tobacco products or cigarette papers or tubes from the factory or from internal revenue bond *under section 5704*, as the Secretary shall by regulation prescribe, or release from customs custody, and shall also include the smuggling or other unlawful importation of such articles into the United States.

* * *

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(4) amended Code Sec. 5702(k) by inserting "under section 5704" after "internal revenue bond".

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[*Caution: Code Sec. 5702(p), below, as added by Act Sec. 9302(g)(2) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.*]

(p) ROLL-YOUR-OWN TOBACCO.—The term "roll-your-own tobacco" means any tobacco which, because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes.

* * *

[CCH Explanation at ¶ 1257. Committee Reports at ¶ 20,085.]

Amendment Notes

Balanced Budget Act

Act Sec. 9302(g)(2) amended Code Sec. 5702 by adding at the end a new subsection (p) to read as above.

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

Act Sec. 9302(k) (as added by Act Sec. 1604(f)(3) of the Taxpayer Relief Act of 1997) provides:

(k) COORDINATION WITH TOBACCO INDUSTRY SETTLEMENT AGREEMENT.—The increase in excise taxes collected as a result of the amendments made by subsections (a), (e), and

(g) of this section shall be credited against the total payments made by parties pursuant to Federal legislation implementing the tobacco industry settlement agreement of June 20, 1997.

[¶ 5572B] CODE SEC. 5704. EXEMPTION FROM TAX.

* * *

[Caution: Code Sec. 5704(b), below, as amended by Act Sec. 9302(h)(1)(A) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(b) TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES TRANSFERRED OR REMOVED IN BOND FROM DOMESTIC FACTORIES AND EXPORT WAREHOUSES.—A manufacturer or export warehouse proprietor may transfer tobacco products and cigarette papers and tubes, without payment of tax, to the bonded premises of another manufacturer or export warehouse proprietor, or remove such articles, without payment of tax, for shipment to a foreign country, Puerto Rico, the Virgin Islands, or a possession of the United States, or for consumption beyond the jurisdiction of the internal revenue laws of the United States; and manufacturers may similarly remove such articles for use of the United States; in accordance with such regulations and under such bonds as the Secretary shall prescribe. *Tobacco products and cigarette papers and tubes may not be transferred or removed under this subsection unless such products or papers and tubes bear such marks, labels, or notices as the Secretary shall by regulations prescribe.*

* * *

[CCH Explanation at ¶ 1257. Committee Reports at ¶ 20,085.]

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(1)(A) amended Code Sec. 5704(b) by adding at the end a new sentence to read as above.

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[Caution: Code Sec. 5712, below, as amended by Act Sec. 9302(h)(2)(A) and (5) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

[¶ 5572C] CODE SEC. 5712. APPLICATION FOR PERMIT.

Every person, before commencing business as a manufacturer *or importer* of tobacco products or as an export warehouse proprietor, and at such other time as the Secretary shall by regulation prescribe, shall make application for the permit provided for in section 5713. The application shall be in such form as the Secretary shall prescribe and shall set forth, truthfully and accurately, the information called for on the form. Such application may be rejected and the permit denied if the Secretary, after notice and opportunity for hearing, finds that—

(1) the premises on which it is proposed to conduct the business are not adequate to protect the revenue;

(2) the activity proposed to be carried out at such premises does not meet such minimum capacity or activity requirements as the Secretary may prescribe, or

(3) such person (including, in the case of a corporation, any officer, director, or principal stockholder and, in the case of a partnership, a partner) is, by reason of his business experience, financial standing, or trade connections, not likely to maintain operations in compliance with this chapter, or has failed to disclose any material information required or made any material false statement in the application therefor.

[CCH Explanation at ¶ 1257. Committee Reports at ¶ 20,085.]

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(2)(A) amended Code Sec. 5712 by inserting "or importer" after "manufacturer".

Act Sec. 9302(h)(5) amended Code Sec. 5712 by striking "or" at the end of paragraph (1), by redesignating paragraph (2) as paragraph (3), and by inserting after paragraph (1) a new paragraph (2) to read as above.

The above amendments generally apply to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[¶ 5572D] CODE SEC. 5713. PERMIT.

[Caution: Code Sec. 5713(a), below, as amended by Act Sec. 9302(h)(2)(A) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(a) ISSUANCE.—A person shall not engage in business as a manufacturer *or importer* of tobacco products or as an export warehouse proprietor without a permit to engage in such business. Such permit, conditioned upon compliance with this chapter and regulations issued thereunder, shall be issued in such form and in such manner as the Secretary shall by regulation prescribe, to every person properly qualified under sections 5711 and 5712. A new permit may be required at such other time as the Secretary shall by regulation prescribe.

* * *

[CCH Explanation at ¶ 1257. Committee Reports at ¶ 20,085.]

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(2)(A) amended Code Sec. 5713(a) by inserting "or importer" after "manufacturer".

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[Caution: Code Sec. 5721, below, as amended by Act Sec. 9302(h)(2)(A) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

[¶ 5572E] CODE SEC. 5721. INVENTORIES.

Every manufacturer *or importer* of tobacco products or cigarette papers and tubes, and every export warehouse proprietor, shall make a true and accurate inventory at the time of commencing business, at the time of concluding business, and at such other times, in such manner and form, and to include such items, as the Secretary shall by regulation prescribe. Such inventories shall be subject to verification by any revenue officer.

* * *

[CCH Explanation at ¶ 1257. Committee Reports at ¶ 20,085.]

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(2)(A) amended Code Sec. 5721 by inserting "or importer" after "manufacturer".

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[Caution: Code Sec. 5722, below, as amended by Act Sec. 9302(h)(2)(A) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

[¶ 5572F] CODE SEC. 5722. REPORTS.

Every manufacturer *or importer* of tobacco products or cigarette papers and tubes, and every export warehouse proprietor, shall make reports containing such information, in such form, at such times, and for such periods as the Secretary shall by regulation prescribe.

* * *

[CCH Explanation at ¶ 1257. Committee Reports at ¶ 20,085.]

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(2)(A) amended Code Sec. 5722 by inserting "or importer" after "manufacturer".

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[Caution: Code Sec. 5754, below, as added by Act Sec. 9302(h)(1)(E)(i) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

[¶ 5572G] *CODE SEC. 5754. RESTRICTION ON IMPORTATION OF PREVIOUSLY EXPORTED TOBACCO PRODUCTS.*

(a) IN GENERAL.—Tobacco products and cigarette papers and tubes previously exported from the United States may be imported or brought into the United States only as provided in section 5704(d). For purposes of this section, section 5704(d), section 5761, and such other provisions as the Secretary may specify by regulations, references to exportation shall be treated as including a reference to shipment to the Commonwealth of Puerto Rico.

(b) CROSS REFERENCE.—For penalty for the sale of tobacco products and cigarette papers and tubes in the United States which are labeled for export, see section 5761(c).

[CCH Explanation at ¶ 1257. Committee Reports at ¶ 20,085.]

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(1)(E)(i) amended subpart F of chapter 53 by adding at the end a new Code Sec. 5754 to read as above.

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[¶ 5572H] CODE SEC. 5761. CIVIL PENALTIES.

[Caution: Code Sec. 5761(a), below, as amended by Act Sec. 9302(h)(1)(C) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(a) OMITTING THINGS REQUIRED OR DOING THINGS FORBIDDEN.—Whoever willfully omits, neglects, or refuses to comply with any duty imposed upon him by this chapter, or to do, or cause to be done, any of the things required by this chapter, or does anything prohibited by this chapter, shall, in addition to any other penalty provided in this title, be liable to a penalty of $1,000, to be recovered, with costs of suit, in a civil action, except where a penalty under *subsection (b) or (c)* or under section 6651 or 6653 or part II of subchapter A of chapter 68 may be collected from such person by assessment.

* * *

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(1)(C) amended Code Sec. 5761(a) by by striking "subsection (b)" and inserting "subsection (b) or (c)".

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[Caution: Code Sec. 5761(c), below, as added by Act Sec. 9302(h)(1)(B) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(c) SALE OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES FOR EXPORT.—Except as provided in subsections (b) and (d) of section 5704—

(1) every person who sells, relands, or receives within the jurisdiction of the United States any tobacco products or cigarette papers or tubes which have been labeled or shipped for exportation under this chapter,

(2) every person who sells or receives such relanded tobacco products or cigarette papers or tubes, and

(3) every person who aids or abets in such selling, relanding, or receiving,

shall, in addition to the tax and any other penalty provided in this title, be liable for a penalty equal to the greater of $1,000 or 5 times the amount of the tax imposed by this chapter. All tobacco products and cigarette papers and tubes relanded within the jurisdiction of the United States, and all vessels, vehicles, and aircraft used in such relanding or in removing such products, papers, and tubes from the place where relanded, shall be forfeited to the United States.

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(1)(B) amended Code Sec. 5761 by redesignating subsections (c) and (d) as subsections (d) and (e), respectively, and by inserting after subsection (b) as new subsection (c) to read as above.

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[Caution: Code Sec. 5761(d), below, as amended by Act Sec. 9302(h)(1)(B) and (D) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(d) APPLICABILITY OF SECTION *6665.—The penalties imposed by subsections (b) and (c)* shall be assessed, collected, and paid in the same manner as taxes, as provided in section 6665(a).

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(1)(B) amended Code Sec. 5761 by redesignating subsection (c) as subsection (d).

Act Sec. 9302(h)(1)(D) amended Code Sec. 5761(d), as redesignated by Act Sec. 9302(h)(1)(B), by striking "The penalty imposed by subsection (b)" and inserting "The penalties imposed by subsections (b) and (c)".

The above amendments generally apply to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[Caution: Code Sec. 5761(e), below, as redesignated by Act Sec. 9302(h)(1)(B) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(e) CROSS REFERENCES.—

* * *

[CCH Explanation at ¶ 1257. Committee Reports at ¶ 20,085.]

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(1)(B) amended Code Sec. 5761 by redesignating subsection (d) as subsection (e).

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[¶ 55721] CODE SEC. 5762. CRIMINAL PENALTIES.

[Caution: Code Sec. 5762(a), below, as amended by Act Sec. 9302(h)(2)(A) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(a) FRAUDULENT OFFENSES.—Whoever, with intent to defraud the United States—

(1) ENGAGING IN BUSINESS UNLAWFULLY.—Engages in business as a manufacturer *or importer* of tobacco products or cigarette papers and tubes or as an export warehouse proprietor, without filing the bond and obtaining the permit where required by this chapter or regulations thereunder; or

(2) FAILING TO FURNISH INFORMATION OR FURNISHING FALSE INFORMATION.—Fails to keep or make any record, return, report, or inventory, or keeps or makes any false or fraudulent record, return, report or inventory, required by this chapter or regulations thereunder; or

(3) REFUSING TO PAY OR EVADING TAX.—Refuses to pay any tax imposed by this chapter, or attempts in any manner to evade or defeat the tax or the payment thereof; or

(4) REMOVING TOBACCO PRODUCTS OR CIGARETTE PAPERS OR TUBES UNLAWFULLY.—Removes, contrary to this chapter or regulations thereunder, any tobacco products or cigarette papers or tubes subject to tax under this chapter; or

(5) PURCHASING, RECEIVING, POSSESSING, OR SELLING TOBACCO PRODUCTS OR CIGARETTE PAPERS OR TUBES UNLAWFULLY.—Violates any provision of section 5751(a)(1) or (a)(2); or

(6) DESTROYING, OBLITERATING, OR DETACHING MARKS, LABELS, OR NOTICES BEFORE PACKAGES ARE EMPTIED.—Violates any provision of section 5752.

shall, for each such offense, be fined not more than $10,000, or imprisoned not more than 5 years, or both.

* * *

[CCH Explanation at ¶ 1257. Committee Reports at ¶ 20,085.]

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(2)(A) amended Code Sec. 5762(a)(1) by inserting "or importer" after "manufacturer".

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[¶ 5572J] CODE SEC. 5763. FORFEITURES.

* * *

[Caution: Code Sec. 5763(b), below, as amended by Act Sec. 9302(h)(2)(A)-(B) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(b) PERSONAL PROPERTY OF QUALIFIED MANUFACTURERS, *QUALIFIED IMPORTERS,* AND EXPORT WAREHOUSE PROPRIETORS, ACTING WITH INTENT TO DEFRAUD.—All tobacco products and cigarette papers and tubes, packages, machinery, fixtures, equipment, and all other materials and personal property on the premises of any qualified manufacturer *or importer* of tobacco products or cigarette papers and tubes, or export warehouse proprietor, who, with intent to defraud the United States, fails to keep or make any record, return, report, or inventory, or keeps or makes any false or fraudulent record, return, report, or inventory, required by this chapter; or refuses to pay any tax imposed by this chapter, or attempts in any manner to evade or defeat the tax or the payment thereof; or removes, contrary to any provision of this chapter, any article subject to tax under this chapter, shall be forfeited to the United States.

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(2)(A) amended Code Sec. 5763(b) by inserting "or importer" after "manufacturer".

Act Sec. 9302(h)(2)(B) amended the heading of Code Sec. 5763(b) by inserting "QUALIFIED IMPORTERS," after "MANUFACTURERS,".

The above amendments generally apply to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[Caution: Code Sec. 5763(c), below, as amended by Act Sec. 9302(h)(2)(A) of the Balanced Budget Act of 1997, generally applies to articles removed after December 31, 1999.—CCH.]

(c) REAL AND PERSONAL PROPERTY OF ILLICIT OPERATORS.—All tobacco products, cigarette papers and tubes, machinery, fixtures, equipment, and other materials and personal property on the premises of any person engaged in business as a manufacturer *or importer* of tobacco products or cigarette papers and tubes, or export warehouse proprietor, without filing the bond or obtaining the permit, as required by this chapter, together with all his right, title, and interest in the building in which such business is conducted, and the lot or tract of ground on which the building is located, shall be forfeited to the United States.

* * *

[CCH Explanation at ¶ 1257. Committee Reports at ¶ 20,085.]

Amendment Notes

Balanced Budget Act

Act Sec. 9302(h)(2)(A) amended Code Sec. 5763(c) by inserting "or importer" after "manufacturer".

The above amendment generally applies to articles removed (as defined in Code Sec. 5702(k)) after December 31, 1999. For a transitional rule, see Act Sec. 9302(i)(2) in the amendment notes following Code Sec. 5701(a), above.

[¶ 5573] CODE SEC. 6011. GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST.

* * *

(e) REGULATIONS REQUIRING RETURNS ON MAGNETIC MEDIA, ETC.—

* * *

(2) REQUIREMENTS OF REGULATIONS.—In prescribing regulations under paragraph (1), the Secretary—

(A) shall not require any person to file returns on magnetic media unless such person is required to file at least 250 returns during the calendar year, and

(B) shall take into account (among other relevant factors) the ability of the taxpayer to comply at reasonable cost with the requirements of such regulations.

Notwithstanding the preceding sentence, the Secretary shall require partnerships having more than 100 partners to file returns on magnetic media.

* * *

[CCH Explanation at ¶ 469. Committee Reports at ¶ 12,285.]

Amendment Notes

Act Sec. 1224 amended Code Sec. 6011(e)(2) by adding at the end a new sentence to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

[¶ 5575] CODE SEC. 6012. PERSONS REQUIRED TO MAKE RETURNS OF INCOME.

* * *

(b) RETURNS MADE BY FIDUCIARIES AND RECEIVERS.—

* * *

(6) IRA SHARE OF PARTNERSHIP INCOME.—In the case of a trust which is exempt from taxation under section 408(e), for purposes of this section, the trust's distributive share of items of gross income and gain of any partnership to which subchapter C or D of chapter 63 applies shall be treated as equal to the trust's distributive share of the taxable income of such partnership.

Amendment Notes

Act Sec. 1225 amended Code Sec. 6012(b) by adding at the end a new paragraph (6) to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

(c) CERTAIN INCOME EARNED ABROAD OR FROM SALE OF RESIDENCE.—For purposes of this section, gross income shall be computed without regard to the exclusion provided for in section 121 *(relating to gain from sale of principal residence)* and without regard to the exclusion provided for in section 911 (relating to citizens or residents of the United States living abroad).

* * *

[CCH Explanation at ¶ 129 and 183. Committee Reports at ¶ 10,315 and 12,295.]

Amendment Notes

Act Sec. 312(d)(11) amended Code Sec. 6012(c) by striking "(relating to one-time exclusion of gain from sale of principal residence by individual who has attained age 55)" and inserting "(relating to gain from sale of principal residence)".

The above amendment generally applies to sales and exchanges after May 6, 1997.

[¶ 5577] CODE SEC. 6018. ESTATE TAX RETURNS.

(a) RETURNS BY EXECUTOR.—

(1) CITIZENS OR RESIDENTS.—In all cases where the gross estate at the death of a citizen or resident exceeds *the applicable exclusion amount in effect under section 2010(c) for the calendar year which includes the date of death*, the executor shall make a return with respect to the estate tax imposed by subtitle B.

* * *

(4) *[Stricken.]*

* * *

[CCH Explanation at ¶ 201 and 714. Committee Reports at ¶ 10,365 and 11,465.]

Amendment Notes

Act Sec. 501(a)(1)(C) amended Code Sec. 6018(a)(1) by striking "$600,000" and inserting "the applicable exclusion amount in effect under section 2010(c) for the calendar year which includes the date of death".

The above amendment applies to the estates of decedents dying, and gifts made, after December 31, 1997.

Act Sec. 1073(b)(4) amended Code Sec. 6018(a) by striking paragraph (4). Prior to being stricken, Code Sec. 6018(a)(4) read as follows:

(4) RETURN REQUIRED IF EXCESS RETIREMENT ACCUMULATION TAX.—The executor shall make a return with respect to the estate tax imposed by subtitle B in any case where such tax is increased by reason of section 4980A(d).

The above amendment applies to estates of decedents dying after December 31, 1996.

[¶ 5579] CODE SEC. 6019. GIFT TAX RETURNS.

Any individual who in any calendar year makes any transfer by gift other than—

(1) a transfer which under subsection (b) or (e) of section 2503 is not to be included in the total amount of gifts for such year,

(2) a transfer of an interest with respect to which a deduction is allowed under section 2523, *or*

(3) a transfer with respect to which a deduction is allowed under section 2522 but only if—

(A)(i) such transfer is of the donor's entire interest in the property transferred, and

(ii) no other interest in such property is or has been transferred (for less than adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in subsection (a) or (b) of section 2522, or

(B) such transfer is described in section 2522(d),

shall make a return for such year with respect to the gift tax imposed by subtitle B.

* * *

[CCH Explanation at ¶ 253. Committee Reports at ¶ 12,615.]

Amendment Notes

Act Sec. 1301(a) amended Code Sec. 6019 by striking "or" at the end of paragraph (1), by adding "or" at the end of paragraph (2), and by inserting after paragraph (2) a new paragraph (3) to read as above.

The above amendment applies to gifts made after the date of the enactment of this Act.

[¶ 5581] CODE SEC. 6031. RETURN OF PARTNERSHIP INCOME.

* * *

(b) COPIES TO PARTNERS.—Each partnership required to file a return under subsection (a) for any partnership taxable year shall (on or before the day on which the return for such taxable year was required to be filed) furnish to each person who is a partner or who holds an interest in such partnership as a nominee for another person at any time during such taxable year a copy of such information required to be shown on such return as may be required by regulations. *In the case of an electing large partnership (as defined in section 775), such information shall be furnished on or before the first March 15 following the close of such taxable year.*

* * *

Amendment Notes

Act Sec. 1223(a) amended Code Sec. 6031(b) by adding at the end a new sentence to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

(e) FOREIGN PARTNERSHIPS.—

(1) EXCEPTION FOR FOREIGN PARTNERSHIP.—Except as provided in paragraph (2), the preceding provisions of this section shall not apply to a foreign partnership.

(2) CERTAIN FOREIGN PARTNERSHIPS REQUIRED TO FILE RETURN.—Except as provided in regulations prescribed by the Secretary, this section shall apply to a foreign partnership for any taxable year if for such year, such partnership has—

(A) gross income derived from sources within the United States, or

(B) gross income which is effectively connected with the conduct of a trade or business within the United States.

The Secretary may provide simplified filing procedures for foreign partnerships to which this section applies.

* * *

[CCH Explanation at ¶ 430 and 981. Committee Reports at ¶ 11,755 and 12,275.]

Amendment Notes

Act Sec. 1141(a) amended Code Sec. 6031 by adding at the end a new subsection (e) to read as above.

The above amendment applies to tax years beginning after the date of the enactment of this Act.

[¶ 5583] CODE SEC. 6033. RETURNS BY EXEMPT ORGANIZATIONS.

* * *

(b) CERTAIN ORGANIZATIONS DESCRIBED IN SECTION 501(c)(3).—Every organization described in section 501(c)(3) which is subject to the requirements of subsection (a) shall furnish annually information, at such time and in such manner as the Secretary may by forms or regulations prescribe, setting forth—

* * *

(10) the respective amounts (if any) of the taxes imposed on the organization, or any organization manager of the organization, during the taxable year under any of the following provisions (and the respective amounts (if any) of reimbursements paid by the organization during the taxable year with respect to taxes imposed on any such organization manager under any of such provisions):

(A) section 4911 (relating to tax on excess expenditures to influence legislation),

(B) section 4912 (relating to tax on disqualifying lobbying expenditures of certain organizations), and

(C) section 4955 (relating to taxes on political expenditures of section 501(c)(3) organizations), *except to the extent that, by reason of section 4962, the taxes imposed under such section are not required to be paid or are credited or refunded,*

(11) the respective amounts (if any) of—

(A) the taxes imposed with respect to the organization on any organization manager, or any disqualified person, during the taxable year under section 4958 (relating to taxes on private excess benefit from certain charitable organizations), and

(B) reimbursements paid by the organization during the taxable year with respect to taxes imposed under such section, except to the extent that, by reason of section 4962, the taxes imposed under such section are not required to be paid or are credited or refunded,

* * *

[CCH Explanation at ¶ 621. Committee Reports at ¶ 13,920.]

Amendment Notes

Act Sec. 1603(b)(1)(A) amended Code Sec. 6033(b)(10) by striking all that precedes subparagraph (A) and inserting new material to read as above. Prior to amendment, the material preceding subparagraph (A) of Code Sec. 6033(b)(10) read as follows:

(10) the respective amounts (if any) of the taxes paid by the organization during the taxable year under the following provisions:

Act Sec. 1603(b)(1)(B) amended Code Sec. 6033(b)(10)(C) by adding "except to the extent that, by reason of section 4962, the taxes imposed under such section are not required to be paid or are credited or refunded," at the end.

Act Sec. 1603(b)(2) amended Code Sec. 6033(b)(11) to read as above. Prior to amendment, Code Sec. 6033(b)(11) read as follows:

(11) the respective amounts (if any) of the taxes paid by the organization, or any disqualified person with respect to such organization, during the taxable year under section 4958 (relating to taxes on private excess benefit from certain charitable organizations),

The above amendments are effective as if included in the provisions of the Taxpayer Bill of Rights 2 (P.L. 104-168) to which they relate [effective for tax years beginning after July 30, 1996.—CCH.].

[¶ 5585] CODE SEC. 6034A. INFORMATION TO BENEFICIARIES OF ESTATES AND TRUSTS.

* * *

(c) BENEFICIARY'S RETURN MUST BE CONSISTENT WITH ESTATE OR TRUST RETURN OR SECRETARY NOTIFIED OF INCONSISTENCY.—

(1) IN GENERAL.—A beneficiary of any estate or trust to which subsection (a) applies shall, on such beneficiary's return, treat any reported item in a manner which is consistent with the treatment of such item on the applicable entity's return.

(2) NOTIFICATION OF INCONSISTENT TREATMENT.—

(A) IN GENERAL.—In the case of any reported item, if—

(i)(I) the applicable entity has filed a return but the beneficiary's treatment on such beneficiary's return is (or may be) inconsistent with the treatment of the item on the applicable entity's return, or

(II) the applicable entity has not filed a return, and

(ii) the beneficiary files with the Secretary a statement identifying the inconsistency, paragraph (1) shall not apply to such item.

(B) BENEFICIARY RECEIVING INCORRECT INFORMATION.—A beneficiary shall be treated as having complied with clause (ii) of subparagraph (A) with respect to a reported item if the beneficiary—

(i) demonstrates to the satisfaction of the Secretary that the treatment of the reported item on the beneficiary's return is consistent with the treatment of the item on the statement furnished under subsection (a) to the beneficiary by the applicable entity, and

(ii) elects to have this paragraph apply with respect to that item.

(3) EFFECT OF FAILURE TO NOTIFY.—In any case—

(A) described in subparagraph (A)(i)(I) of paragraph (2), and

(B) in which the beneficiary does not comply with subparagraph (A)(ii) of paragraph (2), any adjustment required to make the treatment of the items by such beneficiary consistent with the treatment of the items on the applicable entity's return shall be treated as arising out of mathematical or clerical errors and assessed according to section 6213(b)(1). Paragraph (2) of section 6213(b) shall not apply to any assessment referred to in the preceding sentence.

(4) DEFINITIONS.—For purposes of this subsection—

(A) REPORTED ITEM.—The term "reported item" means any item for which information is required to be furnished under subsection (a).

(B) APPLICABLE ENTITY.—The term "applicable entity" means the estate or trust of which the taxpayer is the beneficiary.

(5) ADDITION TO TAX FOR FAILURE TO COMPLY WITH SECTION.—For addition to tax in the case of a beneficiary's negligence in connection with, or disregard of, the requirements of this section, see part II of subchapter A of chapter 68.

* * *

[CCH Explanation at ¶ 273. Committee Reports at ¶ 11,245.]

Amendment Notes

Act Sec. 1027(a) amended Code Sec. 6034A by adding at the end a new subsection (c) to read as above.

The above amendment applies to returns of beneficiaries and owners filed after the date of the enactment of this Act.

[¶ 5587] *CODE SEC. 6038. INFORMATION REPORTING WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS AND PARTNERSHIPS.*

(a) REQUIREMENT.—

(1) IN GENERAL.—Every United States person shall furnish, with respect to any foreign business entity which such person controls, such information as the Secretary may prescribe relating to—

(A) the name, the principal place of business, and the nature of business of such entity, and the country under whose laws such entity is incorporated (or organized in the case of a partnership);

(B) in the case of a foreign corporation, its post-1986 undistributed earnings (as defined in section 902(c));

(C) a balance sheet for such entity listing assets, liabilities, and capital;

(D) transactions between such entity and—

(i) such person,

(ii) any corporation or partnership which such person controls, and

(iii) any United States person owning, at the time the transaction takes place—

(I) in the case of a foreign corporation, 10 percent or more of the value of any class of stock outstanding of such corporation, and

(II) in the case of a foreign partnership, at least a 10-percent interest in such partnership; and

(E)(i) in the case of a foreign corporation, a description of the various classes of stock outstanding, and a list showing the name and address of, and number of shares held by, each United States person who is a shareholder of record owning at any time during the annual accounting period 5 percent or more in value of any class of stock outstanding of such foreign corporation, and

(ii) information comparable to the information described in clause (i) in the case of a foreign partnership.

The Secretary may also require the furnishing of any other information which is similar or related in nature to that specified in the preceding sentence or which the Secretary determines to be appropriate to carry out the provisions of this title.

(2) PERIOD FOR WHICH INFORMATION IS TO BE FURNISHED, ETC.—The information required under paragraph (1) shall be furnished for the annual accounting period of the *foreign business entity* ending with or within the United States person's taxable year. The information so required shall be furnished at such time and in such manner as the Secretary shall by regulations prescribe.

(3) LIMITATION.—No information shall be required to be furnished under this subsection with respect to any *foreign business entity* for any annual accounting period unless such information was required to be furnished under regulations in effect on the first day of such annual accounting period.

* * *

(5) INFORMATION REQUIRED FROM 10-PERCENT PARTNER OF CONTROLLED FOREIGN PARTNERSHIP.—In the case of a foreign partnership which is controlled by United States persons holding at least 10-percent interests (but not by any one United States person), the Secretary may require each United States person who holds a 10-percent interest in such partnership to furnish information relating to such partnership, including information relating to such partner's ownership interests in the partnership and allocations to such partner of partnership items.

Amendment Notes

Act Sec. 1142(a) amended so much of Code Sec. 6038(a) as precedes paragraph (2) to read as above. Prior to amendment, that portion of Code Sec. 6038(a) read as follows:

SEC. 6038. INFORMATION WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.

(a) REQUIREMENT.—

(1) IN GENERAL.—Every United States person shall furnish, with respect to any foreign corporation which such person controls (within the meaning of subsection (e)(1)), such information as the Secretary may prescribe by regulations relating to—

(A) the name, the principal place of business, and the nature of business of such foreign corporation, and the country under whose laws incorporated;

(B) the post-1986 undistributed earnings (as defined in section 902(c)) of such foreign corporation;

(C) a balance sheet for such foreign corporation listing assets, liabilities, and capital;

(D) transactions between such foreign corporation and—

(i) such person,

(ii) any other corporation which such person controls, and

(iii) any United States person owning, at the time the transaction takes place, 10 percent or more of the value of any class of stock outstanding of such foreign corporation; and

(E) a description of the various classes of stock outstanding, and a list showing the name and address of, and number of shares held by, each United States person who is a shareholder of record owning at any time during the annual accounting period 5 percent or more in value of any class of stock outstanding of such foreign corporation.

The Secretary may also require the furnishing of any other information which is similar or related in nature to that specified in the preceding sentence or which the Secretary determines to be appropriate to carry out the provisions of this title.

Act Sec. 1142(d) amended Code Sec. 6038(a) by adding at the end a new paragraph (5) to read as above.

Act Sec. 1142(e)(1)(A) amended Code Sec. 6038(a)(2) and (3) by striking "foreign corporation" each place it appears and inserting "foreign business entity".

The above amendments apply to annual accounting periods beginning after the date of the enactment of this Act.

(b) DOLLAR PENALTY FOR FAILURE TO FURNISH INFORMATION.—

(1) IN GENERAL.—If any person fails to furnish, within the time prescribed under paragraph (2) of subsection (a), any information with respect to any *foreign business entity* required under paragraph (1) of subsection (a), such person shall pay a penalty of *$10,000* for each annual accounting period with respect to which such failure exists.

(2) INCREASE IN PENALTY WHERE FAILURE CONTINUES AFTER NOTIFICATION.—If any failure described in paragraph (1) continues for more than 90 days after the day on which the Secretary mails notice of such failure to the United States person, such person shall pay a penalty (in addition to the amount required under paragraph (1)) of *$10,000* for each 30-day period (or fraction thereof) during which such failure continues with respect to any annual accounting period after the expiration of such 90-day period. The increase in any penalty under this paragraph shall not exceed *$50,000*.

Amendment Notes

Act Sec. 1142(c)(1)(A)-(B) amended Code Sec. 6038(b) by striking "$1,000" each place it appears and inserting "$10,000", and by striking "$24,000" and inserting "$50,000".

Act Sec. 1142(e)(1)(B) amended Code Sec. 6038(b) by striking "foreign corporation" each place it appears and inserting "foreign business entity".

The above amendments apply to annual accounting periods beginning after the date of the enactment of this Act.

(c) PENALTY OF REDUCING FOREIGN TAX CREDIT.—

(1) IN GENERAL.—If a United States person fails to furnish, within the time prescribed under paragraph (2) of subsection (a), any information with respect to any *foreign business entity* required under paragraph (1) of subsection (a), then—

(A) in applying section 901 (relating to taxes of foreign countries and possessions of the United States) to such United States person for the taxable year, the amount of taxes (other than taxes reduced under subparagraph (B)) paid or deemed paid (other than those deemed paid under section 904(c)) to any foreign country or possession of the United States for the taxable year shall be reduced by 10 percent, and

(B) *in the case of a foreign business entity which is a foreign corporation,* in applying sections 902 (relating to foreign tax credit for corporate stockholder in foreign corporation) and 960 (relating to special rules for foreign tax credit) to any such United States person which is a corporation (or to any person who acquires from any other person any portion of the interest of such other person in any such foreign corporation, but only to the extent of such portion) for any taxable year, the amount of taxes paid or deemed paid by each foreign corporation with respect to which such person is required to furnish information during the annual accounting period or periods with respect to which such information is required under paragraph (2) of subsection (a) shall be reduced by 10 percent.

If such failure continues 90 days or more after notice of such failure by the Secretary to the United States person, then the amount of the reduction under this paragraph shall be 10 percent plus an additional 5 percent for each 3-month period, or fraction thereof, during which such failure to furnish information continues after the expiration of such 90-day period.

(2) LIMITATION.—The amount of the reduction under paragraph (1) for each failure to furnish information with respect to a *foreign business entity* required under subsection (a)(1) shall not exceed whichever of the following amounts is the greater:

(A) $10,000, or

(B) the income of the *foreign business entity* for its annual accounting period with respect to which the failure occurs.

* * *

Amendment Notes

Act Sec. 1142(e)(1)(C) amended Code Sec. 6038(c) (other than paragraph (1)(B)) by striking "foreign corporation" each place it appears and inserting "foreign business entity".

Act Sec. 1142(e)(2) amended Code Sec. 6038(c)(1)(B) by inserting "in the case of a foreign business entity which is a foreign corporation," after "(B)".

The above amendments apply to annual accounting periods beginning after the date of the enactment of this Act.

(d) TWO OR MORE PERSONS REQUIRED TO FURNISH INFORMATION WITH RESPECT TO SAME *FOREIGN BUSINESS ENTITY*.—Where, but for this subsection, two or more United States persons would be required to furnish information under subsection (a) with respect to the same *foreign business entity* for the same period, the Secretary may by regulations provide that such information shall be required only from one person. To the extent practicable, the determination of which person shall furnish the information shall be made on the basis of actual ownership of stock.

Amendment Notes

Act Sec. 1142(e)(1)(D) amended Code Sec. 6038(d) by striking "foreign corporation" each place it appears and inserting "foreign business entity".

The above amendment applies to annual accounting periods beginning after the date of the enactment of this Act.

(e) DEFINITIONS.—For purposes of this section—

(1) FOREIGN BUSINESS ENTITY.—The term "foreign business entity" means a foreign corporation and a foreign partnership.

(2) CONTROL *OF CORPORATION*.—A person is in control of a corporation if such person owns stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or more than 50 percent of the total value of shares of all classes of stock, of a corporation. If a person is in control (within the meaning of the preceding sentence) of a corporation which in turn owns more than 50 percent of the total combined voting power of all classes of stock entitled to vote of another corporation, or owns more than 50 percent of the total value of the shares of all classes of stock of another corporation, then such person shall be treated as in control of such other corporation. For purposes of this paragraph, the rules prescribed by section 318(a) for determining ownership of stock shall apply; except that—

(A) subparagraphs (A), (B), and (C) of section 318(a)(3) shall not be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person, and

(B) in applying subparagraph (C) of section 318(a)(2), the phrase "10 percent" shall be substituted for the phrase "50 percent" used in subparagraph (C).

(3) PARTNERSHIP-RELATED DEFINITIONS.—

(A) CONTROL.—A person is in control of a partnership if such person owns directly or indirectly more than a 50 percent interest in such partnership.

(B) 50-PERCENT INTEREST.—For purposes of subparagraph (A), a 50-percent interest in a partnership is—

(i) an interest equal to 50 percent of the capital interest, or 50 percent of the profits interest, in such partnership, or

(ii) to the extent provided in regulations, an interest to which 50 percent of the deductions or losses of such partnership are allocated.

For purposes of the preceding sentence, rules similar to the rules of section 267(c) (other than paragraph (3)) shall apply.

(C) 10-PERCENT INTEREST.—A 10-percent interest in a partnership is an interest which would be described in subparagraph (B) if "10 percent" were substituted for "50 percent" each place it appears.

(4) ANNUAL ACCOUNTING PERIOD.—The annual accounting period of a *foreign business entity* is the annual period on the basis of which such corporation regularly computes its income in keeping its books. In the case of a specified *foreign business entity* (as defined in section 898), the taxable year of such corporation shall be treated as its annual accounting period.

* * *

[CCH Explanation at ¶ 983. Committee Reports at ¶ 11,760.]

Amendment Notes

Act Sec. 1142(b)(1)(A)-(C) amended Code Sec. 6038(e) by redesignating paragraphs (1) and (2) as paragraphs (2) and (4), respectively, by inserting before paragraph (2) (as so redesignated) a new paragraph (1) to read as above, and by inserting after paragraph (2) (as so redesignated) a new paragraph (3) to read as above.

Act Sec. 1142(b)(2) amended Code Sec. 6038(e)(2) (as redesignated by Act Sec. 932(b)(1)(A)) by inserting "OF CORPORATION" after "CONTROL" in the heading.

Act Sec. 1142(e)(1)(E) amended Code Sec. 6038(e)(4) (as redesignated by Act Sec. 1142(b)(1)(A)) by striking "foreign corporation" each place it appears and inserting "foreign business entity".

The above amendments apply to annual accounting periods beginning after the date of the enactment of this Act.

[¶ 5589] CODE SEC. 6038B. NOTICE OF CERTAIN TRANSFERS TO FOREIGN PERSONS.

(a) IN GENERAL.—Each United States person who—

(1) transfers property to—

(A) a foreign corporation in an exchange described in section 332, 351, 354, 355, 356, or 361, or

(B) a foreign partnership in a contribution described in section 721 or in any other contribution described in regulations prescribed by the Secretary,

(2) makes a distribution described in section 336 to a person who is not a United States person,

shall furnish to the Secretary, at such time and in such manner as the Secretary shall by regulations prescribe, such information with respect to such exchange or distribution as the Secretary may require in such regulations.

Amendment Notes

Act Sec. 1144(a) amended Code Sec. 6038B(a)(1) to read as above. Prior to amendment, Code Sec. 6038B(a)(1) read as follows:

(1) transfers property to a foreign corporation in an exchange described in section 332, 351, 354,355,356, or 361, or

The above amendment generally applies to transfers made after the date of the enactment of this Act. For a special rule, see Act Sec. 1144(d)(2), below.

Act Sec. 1144(d)(2) provides:

(2) ELECTION OF RETROACTIVE EFFECT.—Section 1494(c) of the Internal Revenue Code of 1986 shall not apply to any transfer after August 20, 1996, if all applicable reporting requirements under section 6038B of such Code (as amended by this section) are satisfied. The Secretary of the Treasury or his delegate may prescribe simplified reporting requirements under the preceding sentence.

(b) EXCEPTIONS FOR CERTAIN TRANSFERS TO FOREIGN PARTNERSHIPS: SPECIAL RULE.—

(1) EXCEPTIONS.—Subsection (a)(1)(B) shall apply to a transfer by a United States person to a foreign partnership only if—

(A) the United States person holds (immediately after the transfer) directly or indirectly at least a 10-percent interest (as defined in section 6046A(d)) in the partnership, or

(B) the value of the property transferred (when added to the value of the property transferred by such person or any related person to such partnership or a related partnership during the 12-month period ending on the date of the transfer) exceeds $100,000.

For purposes of the preceding sentence, the value of any transferred property is its fair market value at the time of its transfer.

(2) SPECIAL RULE.—If by reason of an adjustment under section 482 or otherwise, a contribution described in subsection (a)(1) is deemed to have been made, such contribution shall be treated for purposes of this section as having been made not earlier than the date specified by the Secretary.

Amendment Notes

Act Sec. 1144(b) amended Code Sec. 6038B by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) a new subsection (b) to read as above.

The above amendment generally applies to transfers made after the date of the enactment of this Act. For a special rule, see Act Sec. 1144(d)(2), below.

Act Sec. 1144(d)(2) provides:

(2) ELECTION OF RETROACTIVE EFFECT.—Section 1494(c) of the Internal Revenue Code of 1986 shall not apply to any transfer after August 20, 1996, if all applicable reporting requirements under section 6038B of such Code (as amended by this section) are satisfied. The Secretary of the Treasury or his delegate may prescribe simplified reporting requirements under the preceding sentence.

(c) PENALTY FOR FAILURE TO FURNISH INFORMATION.—

(1) IN GENERAL.—If any United States person fails to furnish the information described in subsection (a) at the time and in the manner required by regulations, such person shall pay a penalty *equal to 10 percent of the fair market value of the property at the time of the exchange (and, in the case of a contribution described in subsection (a)(1)(B), such person shall recognize gain as if the contributed property had been sold for such value at the time of such contribution).*

(2) REASONABLE CAUSE EXCEPTION.—Paragraph (1) shall not apply to any failure if the United States person shows such failure is due to reasonable cause and not to willful neglect.

(3) LIMIT ON PENALTY.—The penalty under paragraph (1) with respect to any exchange shall not exceed $100,000 unless the failure with respect to such exchange was due to intentional disregard.

* * *

[CCH Explanation at ¶ 988. Committee Reports at ¶ 11,770.]

Amendment Notes

Act Sec. 1144(b) amended Code Sec. 6038B by redesignating subsection (b) as subsection (c).

Act Sec. 1144(c)(1) amended Code Sec. 6038B(b)(1) by striking "equal to" and all that follows and inserting "equal to 10 percent of the fair market value of the property at the time of the exchange (and, in the case of a contribution described in subsection (a)(1)(B), such person shall recognize gain as if the contributed property had been sold for such value at the time of such contribution).". Prior to amendment, Code Sec. 6038B(b)(1) read as follows:

(1) IN GENERAL.—If any United States person fails to furnish the information described in subsection (a) at the time and in the manner required by regulations, such person shall pay a penalty equal to 25 percent of the amount of the gain realized on the exchange.

Act Sec. 1144(c)(2) amended Code Sec. 6038B(b) by adding at the end a new paragraph (3) to read as above.

The above amendments apply to transfers made after the date of the enactment of this Act. For a special rule, see Act Sec. 1144(d)(2), below.

Act Sec. 1144(d)(2) provides:

(2) ELECTION OF RETROACTIVE EFFECT.—Section 1494(c) of the Internal Revenue Code of 1986 shall not apply to any transfer after August 20, 1996, if all applicable reporting requirements under section 6038B of such Code (as amended by this section) are satisfied. The Secretary of the Treasury or his delegate may prescribe simplified reporting requirements under the preceding sentence.

[¶ 5591] CODE SEC. 6039D. RETURNS AND RECORDS WITH RESPECT TO CERTAIN FRINGE BENEFIT PLANS.

* * *

(d) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) SPECIFIED FRINGE BENEFIT PLAN.—The term "specified fringe benefit plan" means any plan under section 79, 105, 106, 120, 125, 127, *129, or 137.*

* * *

Amendment Notes

Act Sec. 1601(h)(2)(D)(iii) amended Code Sec. 6039D(d)(1) by striking "or 129" and inserting "129, or 137".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

[¶ 5595] CODE SEC. *6039G*. INFORMATION ON INDIVIDUALS LOSING UNITED STATES CITIZENSHIP.

* * *

Amendment Notes

Act Sec. 1602(h)(1) amended subpart A of part III of subchapter A of chapter 61 by redesignating Code Sec. 6039F[G] (as added by Act Sec. 512 of the Health Insurance Portability and Accountability Act of 1996) as Code Sec. 6039G and by moving such Code Sec. 6039G to immediately after Code Sec. 6039F (as added by Act Sec. 1905 of the Small Business Job Protection Act of 1996).

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which it relates [generally effective for individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995.—CCH.].

[¶ 5597] CODE SEC. 6041A. RETURNS REGARDING PAYMENTS OF REMUNERATION FOR SERVICES AND DIRECT SALES.

* * *

(d) APPLICATIONS TO GOVERNMENTAL UNITS.—

* * *

(3) PAYMENTS TO CORPORATIONS BY FEDERAL EXECUTIVE AGENCIES.—

(A) IN GENERAL.—Notwithstanding any regulation prescribed by the Secretary before the date of the enactment of this paragraph, subsection (a) shall apply to remuneration paid to a corporation by any Federal executive agency (as defined in section 6050M(b)).

(B) EXCEPTION.—Subparagraph (A) shall not apply to—

(i) services under contracts described in section 6050M(e)(3) with respect to which the requirements of section 6050M(e)(2) are met, and

(ii) such other services as the Secretary may specify in regulations prescribed after the date of the enactment of this paragraph.

* * *

[CCH Explanation at ¶ 1055. Committee Reports at ¶ 11,220.]

Amendment Notes

Act Sec. 1022(a) amended Code Sec. 6041A(d) by adding at the end a new paragraph (3) to read as above.

The above amendment applies to returns the due date for which (determined without regard to any extension) is more than 90 days after the date of the enactment of this Act.

[¶ 5599] CODE SEC. 6045. RETURNS OF BROKERS.

* * *

(e) RETURN REQUIRED IN THE CASE OF REAL ESTATE TRANSACTIONS.—

* * *

(5) EXCEPTION FOR SALES OR EXCHANGES OF CERTAIN PRINCIPAL RESIDENCES.—

(A) IN GENERAL.—Paragraph (1) shall not apply to any sale or exchange of a residence for $250,000 or less if the person referred to in paragraph (2) receives written assurance in a form acceptable to the Secretary from the seller that—

(i) such residence is the principal residence (within the meaning of section 121) of the seller,

(ii) if the Secretary requires the inclusion on the return under subsection (a) of information as to whether there is federally subsidized mortgage financing assistance with respect to the mortgage on residences, that there is no such assistance with respect to the mortgage on such residence, and

(iii) the full amount of the gain on such sale or exchange is excludable from gross income under section 121.

If such assurance includes an assurance that the seller is married, the preceding sentence shall be applied by substituting "$500,000" for "$250,000".

The Secretary may by regulation increase the dollar amounts under this subparagraph if the Secretary determines that such an increase will not materially reduce revenues to the Treasury.

(B) SELLER.—For purposes of this paragraph, the term "seller" includes the person relinquishing the residence in an exchange.

Amendment Notes

Act Sec. 312(c) amended Code Sec. 6045(e) by adding at the end a new paragraph (5) to read as above.

For the effective date of the above amendment, see Act Sec. 312(d)[(e)], below.

Act Sec. 312(d)[(e)] provides:

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to sales and exchanges after May 6, 1997.

(2) SALES BEFORE DATE OF ENACTMENT.—At the election of the taxpayer, the amendments made by this section shall not apply to any sale or exchange before the date of the enactment of this Act.

(3) CERTAIN SALES WITHIN 2 YEARS AFTER DATE OF ENACTMENT.—Section 121 of the Internal Revenue Code of 1986 (as amended by this section) shall be applied without regard to subsection (c)(2)(B) thereof in the case of any sale or exchange of property during the 2-year period beginning on the date of the enactment of this Act if the taxpayer held such property on the date of the enactment of this Act and fails to meet the ownership and use requirements of subsection (a) thereof with respect to such property.

(4) BINDING CONTRACTS.—At the election of the taxpayer, the amendments made by this section shall not apply to a sale or exchange after the date of the enactment of this Act, if—

(A) such sale or exchange is pursuant to a contract which was binding on such date, or

(B) without regard to such amendments, gain would not be recognized under section 1034 of the Internal Revenue Code of 1986 (as in effect on the day before the date of the enactment of this Act) on such sale or exchange by reason of a new residence acquired on or before such date or with respect to the acquisition of which by the taxpayer a binding contract was in effect on such date.

This paragraph shall not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) of the Internal Revenue Code of 1986 applies to such individual.

(f) RETURN REQUIRED IN THE CASE OF PAYMENTS TO ATTORNEYS.—

(1) IN GENERAL.—Any person engaged in a trade or business and making a payment (in the course of such trade or business) to which this subsection applies shall file a return under subsection (a) and a statement under subsection (b) with respect to such payment.

(2) APPLICATION OF SUBSECTION.—

(A) IN GENERAL.—This subsection shall apply to any payment to an attorney in connection with legal services (whether or not such services are performed for the payor).

(B) EXCEPTION.—This subsection shall not apply to the portion of any payment which is required to be reported under section 6041(a) (or would be so required but for the dollar limitation contained therein) or section 6051.

[CCH Explanation at ¶ 129 and 1052. Committee Reports at ¶ 10,315, 10,317 and 11,215.]

Amendment Notes

Act Sec. 1021(a) amended Code Sec. 6045 by adding at the end thereof a new subsection (f) to read as above.

The above amendment applies to payments made after December 31, 1997.

[¶ 5601] CODE SEC. 6046. RETURNS AS TO ORGANIZATION OR REORGANIZATION OF FOREIGN CORPORATIONS AND AS TO ACQUISITIONS OF THEIR STOCK.

(a) REQUIREMENT OF RETURN.—

(1) IN GENERAL.—A return complying with the requirements of subsection (b) shall be made by—

(A) each United States citizen or resident who becomes an officer or director of a foreign corporation if a United States person (as defined in section 7701(a)(30)) meets the stock ownership requirements of paragraph (2) with respect to such corporation,

(B) each United States person—

(i) who acquires stock which, when added to any stock owned on the date of such acquisition, meets the stock ownership requirements of paragraph (2) with respect to a foreign corporation, or

(ii) who acquires stock which, without regard to stock owned on the date of such acquisition, meets the stock ownership requirements of paragraph (2) with respect to a foreign corporation,

(C) each person (not described in subparagraph (B)) who is treated as a United States shareholder under section 953(c) with respect to a foreign corporation, and

(D) each person who becomes a United States person while meeting the stock ownership requirements of paragraph (2) with respect to stock of a foreign corporation.

In the case of a foreign corporation with respect to which any person is treated as a United States shareholder under section 953(c), subparagraph (A) shall be treated as including a reference to each United States person who is an officer or director of such corporation.

(2) STOCK OWNERSHIP REQUIREMENTS.—A person meets the stock ownership requirements of this paragraph with respect to any corporation if such person owns 10 percent or more of—

(A) the total combined voting power of all classes of stock of such corporation entitled to vote, or

(B) the total value of the stock of such corporation.

* * *

[CCH Explanation at ¶ 990. Committee Reports at ¶ 11,780.]

Amendment Notes

Act Sec. 1146(a) amended Code Sec. 6046(a) to read as above. Prior to amendment, Code Sec. 6046(a) read as follows:

(a) REQUIREMENT OF RETURN.—A return complying with the requirements of subsection (b) shall be made by—

(1) each United States citizen or resident who is on January 1, 1963, an officer or director of a foreign corporation, 5 percent or more in value of the stock of which is owned by a United States person (as defined in section 7701(a)(30)), or who becomes such an officer or director at any time after such date,

(2) each United States person who on January 1, 1963, owns 5 percent or more in value of the stock of a foreign corporation, or who, at any time after such date—

(A) acquires stock which, when added to any stock owned on January 1, 1963, has a value equal to 5 percent or more of the value of the stock of a foreign corporation, or

(B) acquires an additional 5 percent or more in value of the stock of a foreign corporation,

(3) each person (not described in paragraph (2)) who, at any time after January 1, 1987, is treated as a United States shareholder under section 953(c) with respect to a foreign corporation, and

(4) each person who at any time after January 1, 1963, becomes a United States person while owning 5 percent or more in value of the stock of a foreign corporation.

In the case of a foreign corporation with respect to which any person is treated as a United States shareholder under section 953(c), paragraph (1) shall be treated as including a reference to each United States person who is an officer or director of such corporation.

The above amendment is effective on January 1, 1998.

[¶ 5603] CODE SEC. 6046A. RETURNS AS TO INTERESTS IN FOREIGN PARTNERSHIPS.

(a) REQUIREMENT OF RETURN.—Any United States person, except to the extent otherwise provided by regulations—

(1) who acquires any interest in a foreign partnership,

(2) who disposes of any portion of his interest in a foreign partnership, or

(3) whose proportional interest in a foreign partnership changes substantially,

shall file a return. *Paragraphs (1) and (2) shall apply to any acquisition or disposition only if the United States person directly or indirectly holds at least a 10-percent interest in such partnership either before or after such acquisition or disposition, and paragraph (3) shall apply to any change only if the change is equivalent to at least a 10-percent interest in such partnership.*

* * *

Amendment Notes

Act Sec. 1143(a)(1) amended Code Sec. 6046A(a) by adding at the end a new sentence to read as above.

The above amendment applies to transfers and changes after the date of the enactment of this Act.

(d) 10-PERCENT INTEREST.—For purposes of subsection (a), a 10-percent interest in a partnership is an interest described in section 6038(e)(3)(C).

Amendment Notes

Act Sec. 1143(a)(2) amended Code Sec. 6046A by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) a new subsection (d) to read as above.

The above amendment applies to transfers and changes after the date of the enactment of this Act.

(e) CROSS REFERENCE.—

* * *

[CCH Explanation at ¶ 985 and 986. Committee Reports at ¶ 11,765.]

Amendment Notes

Act Sec. 1143(a)(2) amended Code Sec. 6046A by redesignating subsection (d) as subsection (e).

The above amendment applies to transfers and changes after the date of the enactment of this Act.

[¶ 5605] CODE SEC. 6048. INFORMATION WITH RESPECT TO CERTAIN FOREIGN TRUSTS.

* * *

(b) UNITED STATES *OWNER* OF FOREIGN TRUST.—

* * *

Amendment Notes

Act Sec. 1601(i)(1) amended Code Sec. 6048(b) by striking "GRANTOR" in the heading and inserting "OWNER".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years of U.S. persons beginning after December 31, 1995.—CCH.].

(d) SPECIAL RULES.—

* * *

(5) UNITED STATES PERSON'S RETURN MUST BE CONSISTENT WITH TRUST RETURN OR SECRETARY NOTIFIED OF INCONSISTENCY.— Rules similar to the rules of section 6034A(c) shall apply to items reported by a trust under subsection (b)(1)(B) and to United States persons referred to in such subsection.

* * *

[CCH Explanation at ¶ 273. Committee Reports at ¶ 11,245.]

Amendment Notes

Act Sec. 1027(b) amended Code Sec. 6048(d) by adding at the end a new paragraph (5) to read as above.

The above amendment applies to returns of beneficiaries and owners filed after the date of the enactment of this Act.

[¶ 5607] CODE SEC. 6050Q. CERTAIN LONG-TERM CARE BENEFITS.

* * *

(b) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.— Every person required to make a return under subsection (a) shall furnish to each individual whose name is required to be set forth in such return a written statement showing—

(1) the name*, address, and phone number of the information contact* of the person making the payments, and

(2) the aggregate amount of long-term care benefits paid to the individual which are required to be shown on such return.

The written statement required under the preceding sentence shall be furnished to the individual on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made.

* * *

[CCH Explanation at ¶ 839. Committee Reports at ¶ 13,825.]

Amendment Notes

Act Sec. 1602(d)(1) amended Code Sec. 6050Q(b)(1) by inserting ", address, and phone number of the information contact" after "name".

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which it relates [effective for benefits paid after December 31, 1996.—CCH.].

[¶ 5609] CODE SEC. 6050R. RETURNS RELATING TO CERTAIN PURCHASES OF FISH.

* * *

(c) STATEMENT TO BE FURNISHED WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return a written statement showing—

(1) the *name, address, and phone number of the information contact* of the person required to make such a return, and

(2) the aggregate amount of payments to the person required to be shown on the return.

The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) is required to be made.

* * *

[CCH Explanation at ¶ 1061. Committee Reports at ¶ 13,520.]

Amendment Notes

Act Sec. 1601(a)(1) amended Code Sec. 6050R(c)(1) by striking "name and address" and inserting "name, address, and phone number of the information contact".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for payments made after December 31, 1997.—CCH.].

[¶ 5611] *CODE SEC. 6050S. RETURNS RELATING TO HIGHER EDUCATION TUITION AND RELATED EXPENSES.*

(a) IN GENERAL.—Any person—

(1) which is an eligible educational institution which receives payments for qualified tuition and related expenses with respect to any individual for any calendar year, or

(2) which is engaged in a trade or business and which, in the course of such trade or business—

(A) makes payments during any calendar year to any individual which constitutes reimbursements or refunds (or similar amounts) of qualified tuition and related expenses of such individual, or

(B) except as provided in regulations, receives from any individual interest aggregating $600 or more for any calendar year on 1 or more qualified education loans,

shall make the return described in subsection (b) with respect to the individual at such time as the Secretary may by regulations prescribe.

Amendment Notes

Act Sec. 202(c)(1) amended Code Sec. 6050S(a)(2) to read as above. Prior to amendment, Code Sec. 6050S(a)(2) read as follows:

(2) which is engaged in a trade or business and which, in the course of such trade or business, makes payments during any calendar year to any individual which constitute reimbursements or refunds (or similar amounts) of qualified tuition and related expenses of such individual,

For the effective date of the above amendment, see Act Sec. 202(e), below.

Act Sec. 202(e) provides:

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to any qualified education loan (as defined in section 221(e)(1) of the Internal Revenue Code of 1986, as added by this section) incurred on, before, or after the date of the enactment of this Act, but only with respect to—

(1) any loan interest payment due and paid after December 31, 1997, and

(2) the portion of the 60-month period referred to in section 221(d) of the Internal Revenue Code of 1986 (as added by this section) after December 31, 1997.

(b) FORM AND MANNER OF RETURNS.—A return is described in this subsection if such return—

(1) is in such form as the Secretary may prescribe,

(2) contains—

(A) the name, address, and TIN of the individual with respect to whom payments or interest described in subsection (a) were received from (or were paid to),

(B) the name, address, and TIN of any individual certified by the individual described in subparagraph (A) as the taxpayer who will claim the individual as a dependent for purposes of the deduction allowable under section 151 for any taxable year ending with or within the calendar year, and

(C) the—

(i) aggregate amount of payments for qualified tuition and related expenses received with respect to the individual described in subparagraph (A) during the calendar year,

(ii) aggregate amount of reimbursements or refunds (or similar amounts) paid to such individual during the calendar year, and

(iii) aggregate amount of interest received for the calendar year from such individual,

(D) such other information as the Secretary may prescribe.

Amendment Notes

Act Sec. 202(c)(2)(A) amended Code Sec. 6050S(b)(2)(A) by inserting "or interest" after "payments".

Act Sec. 202(c)(2)(B) amended Code Sec. 6050S(b)(2)(C) by striking "and" at the end of clause (i), by inserting "and" at the end of clause (ii), and by inserting after clause (ii) a new clause (iii) to read as above.

For the effective date of the above amendments, see Act Sec. 202(e) in the amendment notes following Code Sec. 6050S(a), above.

(c) APPLICATION TO GOVERNMENTAL UNITS.—For purposes of this section—

(1) a governmental unit or any agency or instrumentality thereof shall be treated as a person, and

(2) any return required under subsection (a) by such governmental entity shall be made by the officer or employee appropriately designated for the purpose of making such return.

(d) STATEMENTS TO BE FURNISHED TO INDIVIDUALS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under subsection (a) shall furnish to each individual whose name is required to be set forth in such return under subparagraph (A) or (B) of subsection (b)(2) a written statement showing—

(1) the name, address, and phone number of the information contact of the person required to make such return, and

(2) the aggregate amounts described in subparagraph (C) of subsection (b)(2).

The written statement required under the preceding sentence shall be furnished on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made.

(e) DEFINITIONS.—For purposes of this section, the terms "eligible educational institution" and "qualified tuition and related expenses" have the meanings given such terms by section 25A, and except as provided in regulations, the term "qualified education loan" has the meaning given such term by section 221(e)(1).

Amendment Notes

Act Sec. 202(c)(3) amended Code Sec. 6050S(e) by inserting ", and except as provided in regulations, the term 'qualified education loan' has the meaning given such term by section 221(e)(1)" after "section 25A".

For the effective date of the above amendment, see Act Sec. 202(e) in the amendment notes following Code Sec. 6050S(a), above.

(f) RETURNS WHICH WOULD BE REQUIRED TO BE MADE BY 2 OR MORE PERSONS.—Except to the extent provided in regulations prescribed by the Secretary, in the case of any amount received by any person on behalf of another person, only the person first receiving such amount shall be required to make the return under subsection (a).

(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this section. No penalties shall be imposed under part II of subchapter B of chapter 68 with respect to any return or statement required under this section until such time as such regulations are issued.

* * *

[CCH Explanation at ¶ 139 and 157. Committee Reports at ¶ 10,135 and 10,145.]

Amendment Notes

Act Sec. 201(c)(1) amended subpart B of part III of subchapter A of chapter 61 by inserting after Code Sec. 6050R a new Code Sec. 6050S to read as above.

The above amendment applies to expenses paid after December 31, 1997 (in tax years ending after such date), for education furnished in academic periods beginning after such date.

[¶ 5613] CODE SEC. 6103. CONFIDENTIALITY AND DISCLOSURE OF RETURNS AND RETURN INFORMATION.

(a) GENERAL RULE.—Returns and return information shall be confidential, and except as authorized by this title—

(1) no officer or employee of the United States,

(2) no officer or employee of any State, any local child support enforcement agency, or any local agency administering a program listed in subsection (l)(7)(D) who has or had access to returns or return information under this section, and

(3) no other person (or officer or employee thereof) who has or had access to returns or return information under subsection (e)(1)(D)(iii), paragraph *(6), (12), or (16)* of subsection (l), paragraph (2) or (4)(B) of subsection (m), or subsection (n),

shall disclose any return or return information obtained by him in any manner in connection with his service as such an officer or an employee or otherwise or under the provisions of this section. For purposes of this subsection, the term "officer or employee" includes a former officer or employee.

* * *

Amendment Notes

Balanced Budget Act

Act Sec. 11024(b)(2) amended Code Sec. 6103(a)(3) by striking "(6) or (12)" and inserting "(6), (12), or (16)".

For the effective date of the above amendment, see Act Sec. 11721, below.

Act Sec. 11721 provides:

Except as otherwise provided in this title, the provisions of this title shall take effect on the later of October 1, 1997, or the day the District of Columbia Financial Responsibility and Management Assistance Authority certifies that the financial plan and budget for the District government for fiscal year 1998 meet the requirements of section 201(c)(1) of the District of Columbia Financial Responsibility and Management Assistance Act of 1995, as amended by this title.

(d) DISCLOSURE TO STATE TAX OFFICIALS AND STATE AND LOCAL LAW ENFORCEMENT AGENCIES.—

* * *

(5) DISCLOSURE FOR CERTAIN COMBINED REPORTING PROJECT.—The Secretary shall disclose taxpayer identities and signatures for purposes of the demonstration project described in section 967 of the Taxpayer Relief Act of 1997.

Amendment Notes

Act Sec. 976(c) amended Code Sec. 6103(d) by adding at the end a new paragraph (5) to read as above.

The above amendment is effective on the date of the enactment of this Act.

(e) DISCLOSURE TO PERSONS HAVING MATERIAL INTEREST.—

(1) IN GENERAL.—The return of a person shall, upon written request, be open to inspection by or disclosure to—

(A) in the case of the return of an individual—

(i) that individual,

(ii) if property transferred by that individual to a trust is sold or exchanged in a transaction described in section 644, the trustee or trustees, jointly or separately, of such trust to the extent necessary to ascertain any amount of tax imposed upon the trust by section 644,

(iii) the spouse of that individual if the individual and such spouse have signified their consent to consider a gift reported on such return as made one-half by him and one-half by the spouse pursuant to the provisions of section 2513, or

(iv) the child of that individual (or such child's legal representative) to the extent necessary to comply with the provisions of section (1)(g);

* * *

Amendment Notes

Act Sec. 1201(b)(2) amended Code Sec. 6103(e)(1)(A)(iv) by striking "or 59(j)" after "section (1)(g)".

The above amendment applies to tax years beginning after December 31, 1997.

(h) DISCLOSURE TO CERTAIN FEDERAL OFFICERS AND EMPLOYEES FOR PURPOSES OF TAX ADMINISTRATION, ETC.—

* * *

(5) WITHHOLDING OF TAX FROM SOCIAL SECURITY BENEFITS.—Upon written request of the payor agency, the Secretary may disclose available return information from the master files of the Internal Revenue Service with respect to the address and status of an individual as a nonresident alien or as a citizen or resident of the United States to the Social Security Administration or the Railroad Retirement Board (whichever is appropriate) for purposes of carrying out its responsibilities for withholding tax under section 1441 from social security benefits (as defined in section 86(d)).

Amendment Notes

Act Sec. 1283(a) amended Code Sec. 6103(h) by striking paragraph (5) and by redesignating paragraph (6) as paragraph (5). Prior to amendment, Code Sec. 6103(h)(5) read as follows:

(5) PROSPECTIVE JURORS.—In connection with any judicial proceeding described in paragraph (4) to which the United States is a party, the Secretary shall respond to a written inquiry from an attorney of the Department of Justice (including a United States attorney) involved in such proceeding or any person (or his legal representative) who is a party to such proceeding as to whether an individual who is a prospective juror in such proceeding has or has not been the subject of any audit or other tax investigation by the Internal Revenue Service. The Secretary shall limit such response to an affirmative or negative reply to such inquiry.

The above amendment applies to judicial proceedings commenced after the date of the enactment of this Act.

(i) DISCLOSURE TO FEDERAL OFFICERS OR EMPLOYEES FOR ADMINISTRATION OF FEDERAL LAWS NOT RELATING TO TAX ADMINISTRATION.—

* * *

(7) COMPTROLLER GENERAL.—

* * *

(B) AUDITS OF OTHER AGENCIES.—

(i) IN GENERAL.—Nothing in this section shall prohibit any return or return information obtained under this title by any Federal agency (other than an agency referred to in subparagraph (A)) *or by a Trustee as defined in the District of Columbia Retirement Protection Act of 1997* for use in any program or activity from being open to inspection by, or disclosure to, officers and employees of the General Accounting Office if such inspection or disclosure is—

(I) for purposes of, and to the extent necessary in, making an audit authorized by law of such program or activity, and

(II) pursuant to a written request by the Comptroller General of the United States to the head of such Federal agency.

* * *

Amendment Notes

Balanced Budget Act

Act Sec. 11024(b)(3) amended Code Sec. 6103(i)(7)(B)(i) by inserting after "(other than an agency referred to in subparagraph (A))" and before the word "for" the words "or by a Trustee as defined in the District of Columbia Retirement Protection Act of 1997,".

For the effective date of the above amendment, see Act Sec. 11721, below.

Act Sec. 11721 provides:

Except as otherwise provided in this title, the provisions of this title shall take effect on the later of October 1, 1997, or the day the District of Columbia Financial Responsibility and Management Assistance Authority certifies that the financial plan and budget for the District government for fiscal year 1998 meet the requirements of section 201(c)(1) of the District of Columbia Financial Responsibility and Management Assistance Act of 1995, as amended by this title.

(k) DISCLOSURE OF CERTAIN RETURNS AND RETURN INFORMATION FOR TAX ADMINISTRATION PURPOSES.—

* * *

(8) LEVIES ON CERTAIN GOVERNMENT PAYMENTS.—

(A) DISCLOSURE OF RETURN INFORMATION IN LEVIES ON FINANCIAL MANAGEMENT SERVICE.—In serving a notice of levy, or release of such levy, with respect to any applicable government payment, the Secretary may disclose to officers and employees of the Financial Management Service—

(i) return information, including taxpayer identity information,

(ii) the amount of any unpaid liability under this title (including penalties and interest), and

(iii) the type of tax and tax period to which such unpaid liability relates.

(B) RESTRICTION ON USE OF DISCLOSED INFORMATION.—Return information disclosed under subparagraph (A) may be used by officers and employees of the Financial Management Service only for the purpose of, and to the extent necessary in, transferring levied funds in satisfaction of the levy, maintaining appropriate agency records in regard to such levy or the release thereof, notifying the taxpayer and the agency certifying such payment that the levy has been honored, or in the defense of any litigation ensuing from the honor of such levy.

(C) APPLICABLE GOVERNMENT PAYMENT.—For purposes of this paragraph, the term "applicable government payment" means—

(i) any Federal payment (other than a payment for which eligibility is based on the income or assets (or both) of a payee) certified to the Financial Management Service for disbursement, and

(ii) any other payment which is certified to the Financial Management Service for disbursement and which the Secretary designates by published notice.

[*Caution: Code Sec. 6103(k)(8)[(9)], below, as added by Act Sec. 1205(c)(1) of the Taxpayer Relief Act of 1997, is effective on the day 9 months after the date of the enactment of the Act.—CCH.*]

(8)[(9)] DISCLOSURE OF INFORMATION TO ADMINISTER SECTION 6311.—The Secretary may disclose returns or return information to financial institutions and others to the extent the Secretary deems necessary for the administration of section 6311. Disclosures of information for purposes other than to accept payments by checks or money orders shall be made only to the extent authorized by written procedures promulgated by the Secretary.

Amendment Notes

Act Sec. 1026(a) amended Code Sec. 6103(k) by adding at the end a new paragraph (8) to read as above.

The above amendment applies to levies issued after the date of the enactment of this Act.

Act Sec. 1205(c)(1) amended Code Sec. 6103(k) by adding at the end a new paragraph (8)[(9)] to read as above.

The above amendment is effective on the day 9 months after the date of the enactment of this Act.

(l) DISCLOSURE OF RETURNS AND RETURN INFORMATION FOR PURPOSES OTHER THAN TAX ADMINISTRATION.—

* * *

(7) DISCLOSURE OF RETURN INFORMATION TO FEDERAL, STATE, AND LOCAL AGENCIES ADMINISTERING CERTAIN PROGRAMS UNDER THE SOCIAL SECURITY ACT, THE FOOD STAMP ACT OF 1977, OR TITLE 38, UNITED STATES CODE, OR CERTAIN HOUSING ASSISTANCE PROGRAMS.—

* * *

(D) PROGRAMS TO WHICH RULE APPLIES.—The programs to which this paragraph applies are:

* * *

(viii)(I) any needs-based pension provided under chapter 15 of title 38, United States Code, or under any other law administered by the Secretary of Veterans Affairs;

(II) parents' dependency and indemnity compensation provided under section 1315 of title 38, United States Code;

(III) health-care services furnished under sections 1710(a)(1)(I), 1710(a)(2), 1710(b), and 1712(a)(2)(B) of such title; and

(IV) compensation paid under chapter 11 of title 38, United States Code, at the 100 percent rate based solely on unemployability and without regard to the fact that the disability or disabilities are not rated as 100 percent disabling under the rating schedule.

Only return information from returns with respect to net earnings from self-employment and wages may be disclosed under this paragraph for use with respect to any program described in clause (viii) (IV). Clause (viii) shall not apply after September 30, *2003*; and

(ix) any housing assistance program administered by the Department of Housing and Urban Development that involves initial and periodic review of an applicant's or participant's income, except that return information may be disclosed under this clause only on written request by the Secretary of Housing and Urban Development and only for use by officers and employees of the Department of Housing and Urban Development with respect to applicants for and participants in such programs.

Clause (ix) shall not apply after September 30, 1998.

* * *

(10) Disclosure of certain information to agencies requesting a reduction under section 6402(c) or 6402(d).—

(A) Return information from internal revenue service.—The Secretary may, upon receiving a written request, disclose to officers and employees of any agency seeking a reduction under subsection *(c) or (d)* of section 6402 and to officers and employees of the Department of the Treasury in connection with such reduction—

(i) taxpayer identity information with respect to the taxpayer against whom such a reduction was made or not made and with respect to any other person filing a joint return with such taxpayer,

(ii) the fact that a reduction has been made or has not been made under such subsection with respect to such taxpayer,

(iii) the amount of such reduction,

(iv) whether such taxpayer filed a joint return, and

(v) the fact that a payment was made (and the amount of the payment) to the spouse of the taxpayer on the basis of a joint return.

(B) Restriction on use of disclosed information.—Any officers and employees of an agency receiving return information under subparagraph (A) shall use such information only for the purposes of, and to the extent necessary in, establishing appropriate agency records, locating any person with respect to whom a reduction under subsection *(c) or (d)* of section 6402 is sought for purposes of collecting the debt with respect to which the reduction is sought, or in the defense of any litigation or administrative procedure ensuing from a reduction made under subsection *(c) or (d)* of section 6402.

* * *

(12) Disclosure of certain taxpayer identity information for verification of employment status of medicare beneficiary and spouse of medicare beneficiary.—

* * *

(F) *[Stricken.]*

* * *

(16) Disclosure of return information for purposes of administering the District of Columbia Retirement Protection Act of 1997.—

(A) In general.—Upon written request available return information (including such information disclosed to the Social Security Administration under paragraph (1) or (5) of this subsection), relating to the amount of wage income (as defined in section 3121(a) or 3401(a)), the name, address, and identifying number assigned under section 6109, of payors of wage income, taxpayer identity (as defined in subsection 6103(b)(6)), and the occupational status reflected on any return filed by, or with respect to, any individual with respect to whom

eligibility for, or the correct amount of, benefits under the District of Columbia Retirement Protection Act of 1997, is sought to be determined, shall be disclosed by the Commissioner of Social Security, or to the extent not available from the Social Security Administration, by the Secretary, to any duly authorized officer or employee of the Department of the Treasury, or a Trustee or any designated officer or employee of a Trustee (as defined in the District of Columbia Retirement Protection Act of 1997), or any actuary engaged by a Trustee under the terms of the District of Columbia Retirement Protection Act of 1997, whose official duties require such disclosure, solely for the purpose of, and to the extent necessary in, determining an individual's eligibility for, or the correct amount of, benefits under the District of Columbia Retirement Protection Act of 1997.

(B) DISCLOSURE FOR USE IN JUDICIAL OR ADMINISTRATIVE PROCEEDINGS.—Return information disclosed to any person under this paragraph may be disclosed in a judicial or administrative proceeding relating to the determination of an individual's eligibility for, or the correct amount of, benefits under the District of Columbia Retirement Protection Act of 1997.

* * *

Amendment Notes

Act Sec. 1023(a) amended Code Sec. 6103(l)(7)(D)(viii) by striking "1998" and inserting "2003".

The above amendment is effective on the date of the enactment of this Act.

Balanced Budget Act

Act Sec. 4631(c)(2) amended Code Sec. 6103(l)(12) by striking subparagraph (F). Prior to amendment, Code Sec. 6103(l)(12)(F) read as follows:

(F) TERMINATION.—Subparagraphs (A) and (B) shall not apply to—

(i) any request made after September 30, 1988, and

(ii) any request made before such date for information relating to—

(I) 1997 or thereafter in the case of subparagraph (A), or

(II) 1998 or thereafter in the case of subparagraph (B).

The above amendment is effective on the date of the enactment of this Act.

Act Sec. 5514(a)(1) struck the amendment made by Act. Sec. 110(l)(4)(A)-(B) of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193), which amended Code Sec. 6103(l)(10) by striking "(c) or (d)" each place it appeared and inserting "(c), (d), or (e)" and which added at the end of subparagraph (B) a new last sentence. Thus, the provisions of law amended by such section are restored as if such section had not been enacted. Prior to the amendment's being stricken, the last sentence of Code Sec. 6103(l)(10)(B), as added by P.L. 104-193, read as follows:

Any return information disclosed with respect to section 6402(e) shall only be disclosed to officers and employees of the State agency requesting such information.

The above amendment is effective on July 1, 1997.

Act Sec. 11024(b)(1) amended Code Sec. 6103(l) by adding at the end a new paragraph (16) to read as above.

For the effective date of the above amendment, see Act Sec. 11721, below.

Act Sec. 11721 provides:

Except as otherwise provided in this title, the provisions of this title shall take effect on the later of October 1, 1997, or the day the District of Columbia Financial Responsibility and Management Assistance Authority certifies that the financial plan and budget for the District government for fiscal year 1998 meet the requirements of section 201(c)(1) of the District of Columbia Financial Responsibility and Management Assistance Act of 1995, as amended by this title.

(p) PROCEDURE AND RECORDKEEPING.—

* * *

(3) RECORDS OF INSPECTION AND DISCLOSURE.—

(A) SYSTEM OF RECORDKEEPING.—Except as otherwise provided by this paragraph, the Secretary shall maintain a permanent system of standardized records or accountings of all requests for inspection or disclosure of returns and return information (including the reasons for and dates of such requests) and of returns and return information inspected or disclosed under this section. Notwithstanding the provisions of section 552a(c) of title 5, United States Code, the Secretary shall not be required to maintain a record or accounting of requests for inspection or disclosure of returns and return information, or of returns and return information inspected or disclosed, under the authority of subsections (c), (e), (h)(1), (3)(A), or (4), (i)(4), or (7)(A)(ii), (k)(1), *(2), (6), or (8),* (l)(1), (4)(B), (5), (7), (8), (9), (10), (11), (12), (13)[,] (14), *(15), or (16),* (m), or (n). The records or accountings required to be maintained under this paragraph shall be available for examination by the Joint Committee on Taxation or the Chief of Staff of such joint committee. Such record or accounting shall also be available for examination by such person or persons as may be, but only to the extent, authorized to make such examination under section 552a(c)(3) of title 5, United States Code.

* * *

(4) SAFEGUARDS.—Any Federal agency described in subsection (h)(2), *(h)(5),* (i)(1), (2), (3), (5), or (8), (j)(1) or (2), *(k)(8),* (l)(1), (2), (3), *(5), (10),* (11), (13) or (14), or (o)(1), the General Accounting Office, or any agency, body, or commission described in subsection (d), (i)(3)(B)(i), or (8) or (l)(6), (7), (8), (9), *(12), or (16), or any other person described in subsection (l)(16)* shall, as a condition for receiving returns or return information—

(A) establish and maintain, to the satisfaction of the Secretary, a permanent system of standardized records with respect to any request, the reason for such request, and the date of such request made by or of it and any disclosure of return or return information made by or to it;

(B) establish and maintain, to the satisfaction of the Secretary, a secure area or place in which such returns or return information shall be stored;

(C) restrict, to the satisfaction of the Secretary, access to the returns or return information only to persons whose duties or responsibilities require access and to whom disclosure may be made under the provisions of this title;

(D) provide such other safeguards which the Secretary determines (and which he prescribes in regulations) to be necessary or appropriate to protect the confidentiality of the returns or return information;

(E) furnish a report to the Secretary, at such time and containing such information as the Secretary may prescribe, which describes the procedures established and utilized by such agency, body, or commission or the General Accounting Office for ensuring the confidentiality of returns and return information required by this paragraph; and

(F) upon completion of use of such returns or return information—

(i) in the case of an agency, body, or commission described in subsection (d), (i)(3)(B)(i), or (l)(6), (7), (8), *(9), or (16), or any other person described in subsection (l)(16),* return to the Secretary such returns or return information (along with any copies made therefrom) or make such returns or return information undisclosable in any manner and furnish a written report to the Secretary describing such manner,

(ii) in the case of an agency described in subsections (h)(2), *(h)(5),* (i)(1), (2), (3), (5), or (8), (j)(1) or (2), *(k)(8),* (l)(1), (2), (3), (5), (10), (11), (12), (13) or (14), or (o)(1), or the General Accounting Office, either—

(I) return to the Secretary such returns or return information (along with any copies made therefrom),

(II) otherwise make such returns or return information undisclosable, or

(III) to the extent not so returned or made undisclosable, ensure that the conditions of subparagraphs (A), (B), (C), (D), and (E) of this paragraph continue to be met with respect to such returns or return information, and

(iii) in the case of the Department of Health and Human Services for purposes of subsection (m)(6), destroy all such return information upon completion of its use in providing the notification for which the information was obtained, so as to make such information undisclosable;

except that the conditions of subparagraphs (A), (B), (C), (D), and (E) shall cease to apply with respect to any return or return information if, and to the extent that, such return or return information is disclosed in the course of any judicial or administrative proceeding and made a part of the public record thereof. If the Secretary determines that any such agency, body, or commission, *including an agency or any other person described in subsection (l)(16),* or the General Accounting Office has failed to, or does not, meet the requirements of this paragraph, he may, after any proceedings for review established under paragraph (7), take such actions as are necessary to ensure such requirements are met, including refusing to disclose returns or return information *to such agency, body, or commission, including an agency or any other person described in subsection (l)(16),* or the General Accounting Office until he determines that such requirements have been or will be met. In the case of any agency which receives any mailing address under paragraph (2), (4), (6), or (7) of subsection (m) and which discloses any such mailing address to any agent or which receives any information under paragraph (6)(A), *(12)(B), or (16)* of subsection (l) and which discloses any such information to any agent, *or any person including an agent described in subsection (l)(16),* this paragraph shall apply to such agency and each such agent *or other person* (except that, in the case of an agent, *or any person including an agent described in subsection (l)(16),* any report to the Secretary or other action with respect to the Secretary shall be made or taken through such agency). For purposes of applying this paragraph in any case to which subsection (m)(6) applies, the term "return information" includes related blood donor records (as defined in section 1141(h)(2) of the Social Security Act).

* * *

[CCH Explanation at ¶ 185, 1043, 1046, 1047, 1049, 1064, 1070 and 1111. Committee Reports at ¶ 10,925, 11,225, 11,240, 12,120, 12,140, 12,545 and 20,045.]

Amendment Notes

Act Sec. 1026(b)(1)(A) amended Code Sec. 6103(p)(3)(A) by striking "(2), or (6)" and inserting "(2), (6), or (8)".

Act Sec. 1026(b)(1)(B) amended Code Sec. 6103(p)(4) by inserting "(k)(8)," after "(j)(1) or (2)," each place it appears.

The above amendments apply to levies issued after the date of the enactment of this Act.

Act Sec. 1205(c)(3) amended Code Sec. 6103(p)(3)(A) by striking "or (6)" [sic] and inserting "(6), or (8)". [Note: This amendment is redundant in light of the amendment made by Act Sec. 1026(b)(1)(A).—CCH.]

The above amendment takes effect on the day 9 months after the date of the enactment of this Act.

Act Sec. 1283(b) amended Code Sec. 6103(p)(4) by striking "(h)(6)" each place it appears and inserting "(h)(5)".

The above amendment applies to judicial proceedings commenced after the date of the enactment of this Act.

Balanced Budget Act

Act Sec. 5514(a)(1) struck the amendment made by Act. Sec. 110(l)(5)(A)-(B) of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193), which amended Code Sec. 6103(p)(4) in the matter preceding subparagraph (A) by striking "(5), (10)" and inserting "(5)" and by striking "(9), or (12)" and inserting "(9), (10), or (12)". Thus, the provisions of law amended by such section are restored as if such section had not been enacted.

The above amendment is effective on July 1, 1997.

Act Sec. 11024(b)(4) amended Code Sec. 6103(p)(3)(A) by striking "or (15)" and inserting "(15), or (16)".

Act Sec. 11024(b)(5) amended Code Sec. 6103(p)(4) in the matter preceding subparagraph (A) by striking "or (12)" and inserting "(12), or (16), or any other person described in subsection (l)(16)".

Act Sec. 11024(b)(6) amended Code Sec. 6103(p)(4)(F)(i) by striking "or (9)," and inserting "(9), or (16), or any other person described in subsection (l)(16)".

Act Sec. 11024(b)(7)(A)-(F) amended Code Sec. 6103(p)(4)(F) in the matter following clause (iii) by inserting after "any such agency, body or commission" and before the words "for [or] the General Accounting Office" the words ", including an agency or any other person described in subsection (l)(16),"; by striking "to such agency, body, or commission" and inserting "to such agency, body, or commission, including an agency or any other person described in subsection (l)(16),"; by striking "or (12)(B)" and inserting ", (12)(B), or (16)"; by inserting after the words "any agent," and before the words "this paragraph shall" the words "or any person including an agent described in subsection (l)(16),"; by inserting after the words "such agent" and before "(except that" the words "or other person"; and by inserting after the words "an agent," and before the words "any report" the words "or any person including an agent described in subsection (l)(16),".

For the effective date of the above amendments, see Act Sec. 11721, below.

Act Sec. 11721 provides:

Except as otherwise provided in this title, the provisions of this title shall take effect on the later of October 1, 1997, or the day the District of Columbia Financial Responsibility and Management Assistance Authority certifies that the financial plan and budget for the District government for fiscal year 1998 meet the requirements of section 201(c)(1) of the District of Columbia Financial Responsibility and Management Assistance Act of 1995, as amended by this title.

[¶ 5615] CODE SEC. 6111. REGISTRATION OF TAX SHELTERS.

* * *

(d) CERTAIN CONFIDENTIAL ARRANGEMENTS TREATED AS TAX SHELTERS.—

(1) IN GENERAL.—For purposes of this section, the term "tax shelter" includes any entity, plan, arrangement, or transaction—

(A) a significant purpose of the structure of which is the avoidance or evasion of Federal income tax for a direct or indirect participant which is a corporation,

(B) which is offered to any potential participant under conditions of confidentiality, and

(C) for which the tax shelter promoters may receive fees in excess of $100,000 in the aggregate.

(2) CONDITIONS OF CONFIDENTIALITY.—For purposes of paragraph (1)(B), an offer is under conditions of confidentiality if—

(A) the potential participant to whom the offer is made (or any other person acting on behalf of such participant) has an understanding or agreement with or for the benefit of any promoter of the tax shelter that such participant (or such other person) will limit disclosure of the tax shelter or any significant tax features of the tax shelter, or

(B) any promoter of the tax shelter—

(i) claims, knows, or has reason to know,

(ii) knows or has reason to know that any other person (other than the potential participant) claims, or

(iii) causes another person to claim, that the tax shelter (or any aspect thereof) is proprietary to any person other than the potential participant or is otherwise protected from disclosure to or use by others.

For purposes of this subsection, the term "promoter" means any person or any related person (within the meaning of section 267 or 707) who participates in the organization, management, or sale of the tax shelter.

(3) PERSONS OTHER THAN PROMOTER REQUIRED TO REGISTER IN CERTAIN CASES.—

(A) IN GENERAL.—If—

(i) the requirements of subsection (a) are not met with respect to any tax shelter (as defined in paragraph (1)) by any tax shelter promoter, and

(ii) no tax shelter promoter is a United States person, then each United States person who discussed participation in such shelter shall register such shelter under subsection (a).

(B) EXCEPTION.—Subparagraph (A) shall not apply to a United States person who discussed participation in a tax shelter if—

(i) such person notified the promoter in writing (not later than the close of the 90th day after the day on which such discussions began) that such person would not participate in such shelter, and

(ii) such person does not participate in such shelter.

(4) OFFER TO PARTICIPATE TREATED AS OFFER FOR SALE.—For purposes of subsections (a) and (b), an offer to participate in a tax shelter (as defined in paragraph (1)) shall be treated as an offer for sale.

Amendment Notes

Act Sec. 1028(a) amended Code Sec. 6111 by redesignating subsections (d) and (e) as subsections (e) and (f), respectively, and by inserting after subsection (c) a new subsection (d) to read as above.

The above amendment applies to any tax shelter (as defined in Code Sec. 6111(d), as amended by Act. Sec. 1028(a)) interests in which are offered to potential participants after the Secretary of the Treasury prescribes guidance with respect to meeting requirements added by such amendment.

(e) OTHER DEFINITIONS.—For purposes of this section—

* * *

Amendment Notes

Act Sec. 1028(a) amended Code Sec. 6111 by redesignating subsection (d) as subsection (e).

The above amendment applies to any tax shelter (as defined in Code Sec. 6111(d), as amended by Act Sec. 1028(a)) interests in which are offered to potential participants after the Secretary of the Treasury prescribes guidance with respect to meeting requirements added by such amendment.

(f) REGULATIONS.—The Secretary may prescribe regulations which provide—

* * *

[CCH Explanation at ¶ 1058. Committee Reports at ¶ 11,250.]

Amendment Notes

Act Sec. 1028(a) amended Code Sec. 6111 by redesignating subsection (e) as subsection (f).

The above amendment applies to any tax shelter (as defined in Code Sec. 6111(d), as amended by Act Sec. 1028(a)) interests in which are offered to potential participants after the Secretary of the Treasury prescribes guidance with respect to meeting requirements added by such amendment.

[¶ 5617] CODE SEC. 6166. EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX WHERE ESTATE CONSISTS LARGELY OF INTEREST IN CLOSELY HELD BUSINESS.

* * *

(b) DEFINITIONS AND SPECIAL RULES.—

* * *

(7) PARTNERSHIP INTERESTS AND STOCK WHICH IS NOT READILY TRADABLE.—

(A) IN GENERAL.—If the executor elects the benefits of this paragraph (at such time and in such manner as the Secretary shall by regulations prescribe), then—

(i) for purposes of paragraph (1)(B)(i) or (1)(C)(i) (whichever is appropriate) and for purposes of subsection (c), any capital interest in a partnership and any non-readily-tradable stock which (after the application of paragraph (2)) is treated as owned by the decedent shall be treated as included in determining the value of the decedent's gross estate,

(ii) the executor shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a), and

(iii) section 6601(j) (relating to *2-percent* rate of interest) shall not apply.

* * *

(8) STOCK IN HOLDING COMPANY TREATED AS BUSINESS COMPANY STOCK IN CERTAIN CASES.—

(A) IN GENERAL.—If the executor elects the benefits of this paragraph, then—

* * *

(iii) *2-PERCENT* INTEREST RATE NOT TO APPLY.—Section 6601(j) (relating to *2-percent* rate of interest) shall not apply.

* * *

[CCH Explanation at ¶ 227. Committee Reports at ¶ 10,380.]

Amendment Notes

Act Sec. 503(c)(1) amended Code Sec. 6166(b)(7)(A)(iii) and (8)(A)(iii) by striking "4-percent" each place it appears (including the heading) and inserting "2-percent".

The above amendment applies to estates of decedents dying after December 31, 1997.

[¶ 5619] CODE SEC. 6211. DEFINITION OF A DEFICIENCY.

* * *

(c) COORDINATION WITH SUBCHAPTER C.—In determining the amount of any deficiency for purposes of this subchapter, adjustments to partnership items shall be made only as provided in subchapter C.

[CCH Explanation at ¶ 431. Committee Reports at ¶ 12,315.]

Amendment Notes

Act Sec. 1231(b) amended Code Sec. 6211 by adding at the end a new subsection (c) to read as above.

The above amendment applies to partnership tax years ending after the date of the enactment of this Act.

[¶ 5621] CODE SEC. 6212. NOTICE OF DEFICIENCY.

* * *

(c) FURTHER DEFICIENCY LETTERS RESTRICTED.—

* * *

(2) CROSS REFERENCES.—

For assessment as a deficiency notwithstanding the prohibition of further deficiency letters, in the case of—

* * *

(C) Deficiency attributable to activities not engaged in for profit, see section 183(e)(4).

* * *

[CCH Explanation at ¶ 129. Committee Reports at ¶ 10,315.]

Amendment Notes

Act Sec. 312(d)(12) amended Code Sec. 6212(c)(2) by striking subparagraph (C) and by redesignating the succeeding subparagraphs accordingly. Prior to being stricken, Code Sec. 6212(c)(2)(C) read as follows:

(C) Deficiency attributable to gain on sale or exchange of principal residence, see section 1034(j).

The above amendment applies to sales and exchanges after May 6, 1997.

[¶ 5623] CODE SEC. 6213. RESTRICTIONS APPLICABLE TO DEFICIENCIES; PETITION TO TAX COURT.

* * *

(g) DEFINITIONS.—For purposes of this section—

* * *

(2) MATHEMATICAL OR CLERICAL ERROR.—The term "mathematical or clerical error" means—

* * *

(G) an entry on a return claiming the credit under section 32 with respect to net earnings from self-employment described in section 32(c)(2)(A) to the extent the tax imposed by section 1401 (relating to self-employment tax) on such net earnings has not been paid,

(H) an omission of a correct TIN required under section 21 (relating to expenses for household and dependent care services necessary for gainful employment) or section 151 (relating to allowance of deductions for personal exemptions),

(I) an omission of a correct TIN required under section 24(e) (relating to child tax credit) to be included on a return,

(J) an omission of a correct TIN required under section 25A(g)(1) (relating to higher education tuition and related expenses) to be included on a return, and

(J)[(K)] an omission of information required by section 32(k)(2) (relating to taxpayers making improper prior claims of earned income credit).

* * *

[CCH Explanation at ¶ 119, 127 and 139. Committee Reports at ¶ 10,115, 10,135 and 11,537.]

Amendment Notes

Act Sec. 101(d)(2) amended Code Sec. 6213(g)(2) by striking "and" at the end of subparagraph (G), by striking the period at the end of subparagraph (H) and inserting ", and", and by inserting after subparagraph (H) a new subparagraph (I) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

Act Sec. 201(b) amended Code Sec. 6213(g)(2), as amended by Act Sec. 101(d)(2), by striking "and" at the end of subparagraph (H), by striking the period at the end of subparagraph (I) and inserting ", and", and by inserting after subparagraph (I) a new subparagraph (J) to read as above.

The above amendment applies to expenses paid after December 31, 1997 (in tax years ending after such date), for education furnished in academic periods beginning after such date.

Act Sec. 1085(a)(3) amended Code Sec. 6213(g)(2) by striking "and" at the end of subparagraph (H)[(I)], by striking the period at the end of subparagraph (I)[(J)] and inserting ", and", and by inserting after subparagraph (I)[(J)] a new subparagraph (J)[(K)] to read as above.

The above amendment applies to tax years beginning after December 31, 1996.

[¶ 5625] CODE SEC. 6221. TAX TREATMENT DETERMINED AT PARTNERSHIP LEVEL.

Except as otherwise provided in this subchapter, the tax treatment of any partnership *item (and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item)* shall be determined at the partnership level.

[CCH Explanation at ¶ 453. Committee Reports at ¶ 12,365.]

Amendment Notes

Act Sec. 1238(a) amended Code Sec. 6221 by striking "item" and inserting "item (and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item)".

The above amendment applies to partnership tax years ending after the date of the enactment of this Act.

[¶ 5627] CODE SEC. 6225. ASSESSMENTS MADE ONLY AFTER PARTNERSHIP LEVEL PROCEEDINGS ARE COMPLETED.

* * *

(b) PREMATURE ACTION MAY BE ENJOINED.—Notwithstanding section 7421(a), any action which violates subsection (a) may be enjoined in *the proper court, including the Tax Court. The Tax Court shall have no jurisdiction to enjoin any action or proceeding under this subsection unless a timely petition for a readjustment of the partnership items for the taxable year has been filed and then only in respect of the adjustments that are the subject of such petition.*

* * *

[CCH Explanation at ¶ 455. Committee Reports at ¶ 12,370.]

Amendment Notes

Act Sec. 1239(a) amended Code Sec. 6225(b) by striking "the proper court." and inserting "the proper court, including the Tax Court. The Tax Court shall have no jurisdiction to enjoin any action or proceeding under this subsection unless a timely petition for a readjustment of the partnership items for the taxable year has been filed and then only in respect of the adjustments that are the subject of such petition.".

The above amendment applies to partnership tax years ending after the date of the enactment of this Act.

[¶ 5629] CODE SEC. 6226. JUDICIAL REVIEW OF FINAL PARTNERSHIP ADMINISTRATIVE ADJUSTMENTS.

* * *

(b) PETITION BY PARTNER OTHER THAN TAX MATTERS PARTNER.—

* * *

(5) TREATMENT OF PREMATURE PETITIONS.—If—

(A) a petition for a readjustment of partnership items for the taxable year involved is filed by a notice partner (or a 5-percent group) during the 90-day period described in subsection (a), and

(B) no action is brought under paragraph (1) during the 60-day period described therein with respect to such taxable year which is not dismissed,

such petition shall be treated for purposes of paragraph (1) as filed on the last day of such 60-day period.

(6) TAX MATTERS PARTNER MAY INTERVENE.—The tax matters partner may intervene in any action brought under this subsection.

Amendment Notes

Act Sec. 1240(a) amended Code Sec. 6226(b) by redesignating paragraph (5) as paragraph (6) and by inserting after paragraph (4) a new paragraph (5) to read as above.

The above amendment applies to petitions filed after the date of the enactment of this Act.

* * *

(d) PARTNER MUST HAVE INTEREST IN OUTCOME.—

(1) IN ORDER TO BE PARTY TO ACTION.—Subsection (c) shall not apply to a partner after the day on which—

(A) the partnership items of such partner for the partnership taxable year became nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231, or

(B) the period within which any tax attributable to such partnership items may be assessed against that partner expired.

Notwithstanding subparagraph (B), any person treated under subsection (c) as a party to an action shall be permitted to participate in such action (or file a readjustment petition under subsection (b) or paragraph (2) of this subsection) solely for the purpose of asserting that the period of limitations for assessing any tax attributable to partnership items has expired with respect to such person, and the court having jurisdiction of such action shall have jurisdiction to consider such assertion.

* * *

Amendment Notes

Act Sec. 1239(b) amended Code Sec. 6226(d)(1) by adding at the end a new sentence to read as above.

The above amendment applies to partnership tax years ending after the date of the enactment of this Act.

(f) SCOPE OF JUDICIAL REVIEW.—A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of final partnership administrative adjustment *relates*, the proper allocation of such items among the partners, *and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item.*

* * *

[CCH Explanation at ¶ 453, 455 and 457. Committee Reports at ¶ 12,365, 12,370 and 12,375.]

Amendment Notes

Act Sec. 1238(b)(1)(A)-(B) amended Code Sec. 6226(f) by striking "relates and" and inserting "relates,", and by inserting before the period ", and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item".

The above amendment applies to partnership tax years ending after the date of the enactment of this Act.

[¶ 5631] CODE SEC. 6227. ADMINISTRATIVE ADJUSTMENT REQUESTS.

* * *

(b) SPECIAL RULE IN CASE OF EXTENSION OF PERIOD OF LIMITATIONS UNDER SECTION 6229.—The period prescribed by subsection (a)(1) for filing of a request for an administrative adjustment shall be extended—

(1) for the period within which an assessment may be made pursuant to an agreement (or any extension thereof) under section 6229(b), and

(2) for 6 months thereafter.

Amendment Notes

Act Sec. 1236(a) amended Code Sec. 6227 by redesignating subsections (b) and (c) as subsections (c) and (d), respectively, and by inserting after subsection (a) a new subsection (b) to read as above.

The above amendment is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) [generally effective for partnership tax years beginning after September 3, 1982.—CCH.].

(c) REQUESTS BY TAX MATTERS PARTNER ON BEHALF OF PARTNERSHIP.—

* * *

Amendment Notes

Act Sec. 1236(a) amended Code Sec. 6227 by redesignating subsection (b) as subsection (c).

The above amendment is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) [generally effective for partnership tax years beginning after September 3, 1982.—CCH.].

(d) OTHER REQUESTS.—If any partner files a request for an administrative adjustment (other than a request described in subsection (b)), the Secretary may—

(1) process the request in the same manner as a claim for credit or refund with respect to items which are not partnership items,

(2) assess any additional tax that would result from the requested adjustments,

(3) mail to the partner, under subparagraph (A) of section 6231(b)(1) (relating to items becoming nonpartnership items), a notice that all partnership items of the partner for the partnership taxable year to which such request relates shall be treated as nonpartnership items, or

(4) conduct a partnership proceeding.

Amendment Notes

Act Sec. 1236(a) amended Code Sec. 6227 by redesignating subsection (c) as subsection (d).

The above amendment is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) [generally effective for partnership tax years beginning after September 3, 1982.—CCH.].

(e) REQUESTS WITH RESPECT TO BAD DEBTS OR WORTHLESS SECURITIES.—In the case of that portion of any request for an administrative adjustment which relates to the deductibility by the partnership under section 166 of a debt as a debt which became worthless, or under section 165(g) of a loss from worthlessness of a security, the period prescribed in subsection (a)(1) shall be 7 years from the last day for filing the partnership return for the year with respect to which such request is made (determined without regard to extensions).

[CCH Explanation at ¶ 447, 449 and 453. Committee Reports at ¶ 12,355 and 12,390.]

Amendment Notes

Act Sec. 1243(a) amended Code Sec. 6227 by adding at the end a new subsection (e) to read as above.

The above amendment is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) [generally effective for partnership tax years beginning after September 3, 1982.—CCH.]. For a special rule, see Act Sec. 1243(b)(2)(A)-(C), below.

Act Sec. 1243(b)(2)(A)-(C) provides:

(2) TREATMENT OF REQUESTS FILED BEFORE DATE OF ENACTMENT.—In the case of that portion of any request (filed before the date of the enactment of this Act) for an administrative adjustment which relates to the deductibility of a debt as a debt which became worthless or the deductibility of a loss from the worthlessness of a security—

(A) paragraph (2) of section 6227(a) of the Internal Revenue Code of 1986 shall not apply,

(B) the period for filing a petition under section 6228 of the Internal Revenue Code of 1986 with respect to such request shall not expire before the date 6 months after the date of the enactment of this Act, and

(C) such a petition may be filed without regard to whether there was a notice of the beginning of an administrative proceeding or a final partnership administrative adjustment.

[¶ 5633] CODE SEC. 6229. PERIOD OF LIMITATIONS FOR MAKING ASSESSMENTS.

* * *

(b) EXTENSION BY AGREEMENT.—

* * *

(2) SPECIAL RULE WITH RESPECT TO DEBTORS IN TITLE 11 CASES.—Notwithstanding any other law or rule of law, if an agreement is entered into under paragraph (1)(B) and the agreement is signed by a person who would be the tax matters partner but for the fact that, at the time that the agreement is executed, the person is a debtor in a bankruptcy proceeding under title 11 of the United States Code, such agreement shall be binding on all partners in the partnership unless the Secretary has been notified of the bankruptcy proceeding in accordance with regulations prescribed by the Secretary.

(3) COORDINATION WITH SECTION 6501(c)(4).—Any agreement under section 6501(c)(4) shall apply with respect to the period described in subsection (a) only if the agreement expressly provides that such agreement applies to tax attributable to partnership items.

* * *

Amendment Notes

Act Sec. 1233(c) amended Code Sec. 6229(b) by redesignating paragraph (2) as paragraph (3) and by inserting after paragraph (1) a new paragraph (2) to read as above.

The above amendment applies to agreements entered into after the date of enactment of this Act.

(d) SUSPENSION WHEN SECRETARY MAKES ADMINISTRATIVE ADJUSTMENT.—If notice of a final partnership administrative adjustment with respect to any taxable year is mailed to the tax matters partner, the running of the period specified in subsection (a) (as modified by other provisions of this section) shall be suspended—

(1) for the period during which an action may be brought under section 6226 *(and, if a petition is filed under section 6226 with respect to such administrative adjustment, until the decision of the court becomes final), and*

(2) for 1 year thereafter.

* * *

Amendment Notes

Act Sec. 1233(a) amended Code Sec. 6229(d)(1) by striking all that follows "section 6226" and inserting "(and, if a petition is filed under section 6226 with respect to such administrative adjustment, until the decision of the court becomes final), and". Prior to amendment, Code Sec. 6229(d)(1) read as follows:

(1) for the period during which an action may be brought under section 6226 (and, if an action with respect to such administrative adjustment is brought during such period, until the decision of the court in such action becomes final), and

The above amendment applies to partnership tax years with respect to which the period under Code Sec. 6229 for assessing tax has not expired on or before the date of enactment of this Act.

(f) SPECIAL RULES.—

(1) ITEMS BECOMING NONPARTNERSHIP ITEMS.—If, before the expiration of the period otherwise provided in this section for assessing any tax imposed by subtitle A with respect to the partnership items of a partner for the partnership taxable year, such items become nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231, the period for assessing any tax imposed by subtitle A which is attributable to such items (or any item affected by such items) shall not expire before the date which is 1 year after the date on which the items become nonpartnership items. The period described in the preceding sentence (including any extension period under this sentence) may be extended with respect to any partner by agreement entered into by the Secretary and such partner.

(2) SPECIAL RULE FOR PARTIAL SETTLEMENT AGREEMENTS.—If a partner enters into a settlement agreement with the Secretary with respect to the treatment of some of the partnership items in dispute for a partnership taxable year but other partnership items for such year remain in dispute, the period of limitations for assessing any tax attributable to the settled items shall be determined as if such agreement had not been entered into.

* * *

Amendment Notes

Act Sec. 1235(a)(1)-(3) amended Code Sec. 6229(f) by striking "(f) ITEMS BECOMING NONPARTNERSHIP ITEMS.—If" and inserting "(f) SPECIAL RULES.—(1) ITEMS BECOMING NONPARTNERSHIP ITEMS.—If", by moving the text of such subsection 2 ems to the right, and by adding at the end a new paragraph (2) to read as above.

The above amendment applies to settlements entered into after the date of enactment of this Act.

(h) SUSPENSION DURING PENDENCY OF BANKRUPTCY PROCEEDING.—If a petition is filed naming a partner as a debtor in a bankruptcy proceeding under title 11 of the United States Code, the running of the period of limitations provided in this section with respect to such partner shall be suspended—

(1) for the period during which the Secretary is prohibited by reason of such bankruptcy proceeding from making an assessment, and

(2) for 60 days thereafter.

[CCH Explanation at ¶ 437, 438, 439 and 443. Committee Reports at ¶ 12,325, 12,330, 12,335 and 12,350.]

Amendment Notes

Act Sec. 1233(b) amended Code Sec. 6229 by adding at the end a new subsection (h) to read as above.

The above amendment applies to partnership tax years with respect to which the period under Code Sec. 6229 for assessing tax has not expired on or before the date of enactment of this Act.

[¶ 5635] CODE SEC. 6230. ADDITIONAL ADMINISTRATIVE PROVISIONS.

(a) COORDINATION WITH DEFICIENCY PROCEEDINGS.—

(1) IN GENERAL.—Except as provided in *paragraph (2) or (3),* subchapter B of this chapter shall not apply to the assessment or collection of any computational adjustment.

(2) DEFICIENCY PROCEEDINGS TO APPLY IN CERTAIN CASES.—

(A) Subchapter B shall apply to any deficiency attributable to—

(i) affected items which require partner level determinations (other than penalties, additions to tax, and additional amounts that relate to adjustments to partnership items), or

(ii) items which have become nonpartnership items (other than by reason of section 6231(b)(1)(C)) and are described in section 6231(e)(1)(B).

(B) Subchapter B shall be applied separately with respect to each deficiency described in subparagraph (A) attributable to each partnership.

(C) Notwithstanding any other law or rule of law, any notice or proceeding under subchapter B with respect to a deficiency described in this paragraph shall not preclude or be precluded by any other notice, proceeding, or determination with respect to a partner's tax liability for a taxable year.

(3) SPECIAL RULE IN CASE OF ASSERTION BY PARTNER'S SPOUSE OF INNOCENT SPOUSE RELIEF.—

(A) Notwithstanding section 6404(b), if the spouse of a partner asserts that section 6013(e) applies with respect to a liability that is attributable to any adjustment to a partnership item (including any liability for any penalties, additions to tax, or additional amounts relating to such adjustment), then such spouse may file with the Secretary within 60 days after the notice of computational adjustment is mailed to the spouse a request for abatement of the assessment specified in such notice. Upon receipt of such request, the Secretary shall abate the assessment. Any reassessment of the tax with respect to which an abatement is made under this subparagraph shall be subject to the deficiency procedures prescribed by subchapter B. The period for making any such reassessment shall not expire before the expiration of 60 days after the date of such abatement.

(B) If the spouse files a petition with the Tax Court pursuant to section 6213 with respect to the request for abatement described in subparagraph (A), the Tax Court shall only have jurisdiction pursuant to this section to determine whether the requirements of section 6013(e) have been satisfied. For purposes of such determination, the treatment of partnership items (and the applicability of any penalties, additions to tax, or additional amounts) under the settlement, the final partnership administrative adjustment, or the decision of the court (whichever is appropriate) that gave rise to the liability in question shall be conclusive.

(C) Rules similar to the rules contained in subparagraphs (B) and (C) of paragraph (2) shall apply for purposes of this paragraph.

* * *

Amendment Notes

Act Sec. 1237(a) amended Code Sec. 6230(a) by adding at the end a new paragraph (3) to read as above.

Act Sec. 1237(c)(1) amended Code Sec. 6230(a)(1) by striking "paragraph (2)" and inserting "paragraph (2) or (3)".

The above amendments are effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) [generally effective for partnership tax years beginning after September 3, 1982.—CCH.].

Act Sec. 1238(b)(2) amended Code Sec. 6230(a)(2)(A)(i) to read as above. Prior to amendment, Code Sec. 6230(a)(2)(A)(i) read as follows:

(i) affected items which require partner level determinations, or

Act Sec. 1238(b)(3)(A) amended Code Sec. 6230(a)(3)(A), as added by Act Sec. 1237, by inserting "(including any liability for any penalties, additions to tax, or additional amounts relating to such adjustment)" after "partnership item".

Act Sec. 1238(b)(3)(B) amended Code Sec. 6230(a)(3)(B), as added by Act Sec. 1237, by inserting "(and the applicability of any penalties, additions to tax, or additional amounts)" after "partnership items".

The above amendments apply to partnership tax years ending after the date of enactment of this Act.

(c) CLAIMS ARISING OUT OF ERRONEOUS COMPUTATIONS, ETC.—

(1) IN GENERAL.—A partner may file a claim for refund on the grounds that—

(A) the Secretary erroneously computed any computational adjustment necessary—

(i) to make the partnership items on the partner's return consistent with the treatment of the partnership items on the partnership return, or

(ii) to apply to the partner a settlement, a final partnership administrative adjustment, or the decision of a court in an action brought under section 6226 or section 6228(a),

(B) the Secretary failed to allow a credit or to make a refund to the partner in the amount of the overpayment attributable to the application to the partner of a settlement, a final partnership administrative adjustment, or the decision of a court in an action brought under section 6226 or section 6228(a), *or*

(C) the Secretary erroneously imposed any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item.

(2) TIME FOR FILING CLAIM.—

(A) UNDER PARAGRAPH (1)(A) OR (C).—Any claim under subparagraph (A) or (C) of paragraph (1) shall be filed within 6 months after the day on which the Secretary mails the notice of computational adjustment to the partner.

* * *

(4) NO REVIEW OF SUBSTANTIVE ISSUES.—For purposes of any claim or suit under this subsection, the treatment of partnership items on the partnership return, under the settlement, under the final partnership administrative adjustment, or under the decision of the court (whichever is appropriate) shall be conclusive. *In addition, the determination under the final partnership administrative adjustment or under the decision of the court (whichever is appropriate) concerning the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item shall also be conclusive. Notwithstanding the preceding sentence, the partner shall be allowed to assert any partner level defenses that may apply or to challenge the amount of the computational adjustment.*

(5) RULES FOR SEEKING INNOCENT SPOUSE RELIEF.—

(A) IN GENERAL.—The spouse of a partner may file a claim for refund on the ground that the Secretary failed to relieve the spouse under section 6013(e) from a liability that is attributable to an adjustment to a partnership item (including any liability for any penalties, additions to tax, or additional amounts relating to such adjustment).

(B) TIME FOR FILING CLAIM.—Any claim under subparagraph (A) shall be filed within 6 months after the day on which the Secretary mails to the spouse the notice of computational adjustment referred to in subsection (a)(3)(A).

(C) SUIT IF CLAIM NOT ALLOWED.—If the claim under subparagraph (B) is not allowed, the spouse may bring suit with respect to the claim within the period specified in paragraph (3).

(D) PRIOR DETERMINATIONS ARE BINDING.—For purposes of any claim or suit under this paragraph, the treatment of partnership items (and the applicability of any penalties, additions to tax, or additional amounts) under the settlement, the final partnership administrative adjustment, or the decision of the court (whichever is appropriate) that gave rise to the liability in question shall be conclusive.

Amendment Notes

Act Sec. 1237(b) amended Code Sec. 6230(c) by adding at the end a new paragraph (5) to read as above.

The above amendment is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) [generally effective for partnership tax years beginning after September 3, 1982.—CCH.].

Act Sec. 1238(b)(3)(C) amended Code Sec. 6230(c)(5)(A), as added by Act Sec. 1237, by inserting before the period "(including any liability for any penalties, additions to tax, or additional amounts relating to such adjustment)".

Act Sec. 1238(b)(3)(D) amended Code Sec. 6230(c)(5)(D), as added by Act Sec. 1237, by inserting "(and the applicability of any penalties, additions to tax, or additional amounts)" after "partnership items".

Act Sec. 1238(b)(4) amended Code Sec. 6230(c)(1) by striking "or" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", or", and by adding at the end a new subparagraph (C) to read as above.

Act Sec. 1238(b)(5) amended so much of Code Sec. 6230(c)(2)(A) as precedes "shall be filed" to read as above. Prior to amendment, Code Sec. 6230(c)(2)(A) read as follows:

(A) UNDER PARAGRAPH (1)(A).—Any claim under paragraph (1)(A) shall be filed within 6 months after the day on which the Secretary mails the notice of computational adjustment to the partner.

Act Sec. 1238(b)(6) amended Code Sec. 6230(c)(4) by adding at the end two new sentences to read as above.

The above amendments apply to partnership tax years ending after the date of enactment of this Act.

(d) SPECIAL RULES WITH RESPECT TO CREDITS OR REFUNDS ATTRIBUTABLE TO PARTNERSHIP ITEMS.—

* * *

(6) SUBCHAPTER B OF CHAPTER 66 NOT APPLICABLE.—Subchapter B of chapter 66 (relating to limitations on credit or refund) shall not apply to any credit or refund of an overpayment attributable to a partnership item.

* * *

[CCH Explanation at ¶ 451, 453 and 455. Committee Reports at ¶ 12,360, 12,365 and 12,370.]

Amendment Notes

Act Sec. 1239(c)(1) amended Code Sec. 6230(d)(6) by striking "(or an affected item)".

The above amendment applies to partnership tax years ending after the date of enactment of this Act.

[¶ 5637] CODE SEC. 6231. DEFINITIONS AND SPECIAL RULES.

(a) DEFINITIONS.—For purposes of this subchapter—

(1) PARTNERSHIP.—

* * *

(B) EXCEPTION FOR SMALL PARTNERSHIPS.—

(i) In General.—The term "partnership" shall not include any partnership having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner. For purposes of the preceding sentence, a husband and wife (and their estates) shall be treated as 1 partner.

* * *

Amendment Notes

Act Sec. 1234(a) amended Code Sec. 6231(a)(1)(B)(i) to read as above. Prior to amendment, Code Sec. 6231(a)(1)(B)(i) read as follows:

(i) In general.—The term "partnership" shall not include any partnership if—

(I) such partnership has 10 or fewer partners each of whom is a natural person (other than a nonresident alien) or an estate, and

(II) each partner's share of each partnership item is the same as his share of every other item.

For purposes of the preceding sentence, a husband and wife (and their estates) shall be treated as 1 partner.

The above amendment applies to partnership tax years ending after the date of the enactment of this Act.

(f) Special Rule for *Deductions, Losses, and* Credits of Foreign Partnerships.—Except to the extent otherwise provided in regulations, in the case of any partnership the tax matters partner of which resides outside the United States or the books of which are maintained outside the United States, no *deduction, loss, or* credit shall be allowable to any partner unless section 6031 is complied with for the partnership's taxable year in which such *deduction, loss, or* credit arose at such time as the Secretary prescribes by regulations.

Amendment Notes

Act Sec. 1141(b)(1)-(2) amended Code Sec. 6231(f) by striking "Losses and" in the heading and inserting "Deductions, Losses, and", and by striking "loss or" each place it apppears and inserting "deduction, loss, or".

The above amendment applies to tax years beginning after the date of the enactment of this Act.

(g) Partnership Return To Be Determinative of Whether Subchapter Applies.—

(1) Determination that subchapter applies.—If, on the basis of a partnership return for a taxable year, the Secretary reasonably determines that this subchapter applies to such partnership for such year but such determination is erroneous, then the provisions of this subchapter are hereby extended to such partnership (and its items) for such taxable year and to partners of such partnership.

(2) Determination that subchapter does not apply.—If, on the basis of a partnership return for a taxable year, the Secretary reasonably determines that this subchapter does not apply to such partnership for such year but such determination is erroneous, then the provisions of this subchapter shall not apply to such partnership (and its items) for such taxable year or to partners of such partnership.

[CCH Explanation at ¶ 435, 445 and 981. Committee Reports at ¶ 11,755, 12,320 and 12,345.]

Amendment Notes

Act Sec. 1232(a) amended Code Sec. 6231 by adding at the end a new subsection (g) to read as above.

The above amendment applies to partnership tax years ending after the date of the enactment of this Act.

[¶ 5639] *CODE SEC. 6234. DECLARATORY JUDGMENT RELATING TO TREATMENT OF ITEMS OTHER THAN PARTNERSHIP ITEMS WITH RESPECT TO AN OVERSHELTERED RETURN.*

(a) General Rule.—If—

(1) a taxpayer files an oversheltered return for a taxable year,

(2) the Secretary makes a determination with respect to the treatment of items (other than partnership items) of such taxpayer for such taxable year, and

(3) the adjustments resulting from such determination do not give rise to a deficiency (as defined in section 6211) but would give rise to a deficiency if there were no net loss from partnership items, the Secretary is authorized to send a notice of adjustment reflecting such determination to the taxpayer by certified or registered mail.

(b) Oversheltered Return.—For purposes of this section, the term "oversheltered return" means an income tax return which—

(1) shows no taxable income for the taxable year, and

(2) shows a net loss from partnership items.

(c) Judicial Review in the Tax Court.—Within 90 days, or 150 days if the notice is addressed to a person outside the United States, after the day on which the notice of adjustment authorized in subsection (a) is mailed to the taxpayer, the taxpayer may file a petition with the Tax Court for redetermination of the adjustments. Upon the filing of such a petition, the Tax Court shall have jurisdiction to make a

declaration with respect to all items (other than partnership items and affected items which require partner level determinations as described in section 6230(a)(2)(A)(i)) for the taxable year to which the notice of adjustment relates, in accordance with the principles of section 6214(a). Any such declaration shall have the force and effect of a decision of the Tax Court and shall be reviewable as such.

(d) FAILURE TO FILE PETITION.—

(1) IN GENERAL.—Except as provided in paragraph (2), if the taxpayer does not file a petition with the Tax Court within the time prescribed in subsection (c), the determination of the Secretary set forth in the notice of adjustment that was mailed to the taxpayer shall be deemed to be correct.

(2) EXCEPTION.—Paragraph (1) shall not apply after the date that the taxpayer—

(A) files a petition with the Tax Court within the time prescribed in subsection (c) with respect to a subsequent notice of adjustment relating to the same taxable year, or

(B) files a claim for refund of an overpayment of tax under section 6511 for the taxable year involved.

If a claim for refund is filed by the taxpayer, then solely for purposes of determining (for the taxable year involved) the amount of any computational adjustment in connection with a partnership proceeding under this subchapter (other than under this section) or the amount of any deficiency attributable to affected items in a proceeding under section 6230(a)(2), the items that are the subject of the notice of adjustment shall be presumed to have been correctly reported on the taxpayer's return during the pendency of the refund claim (and, if within the time prescribed by section 6532 the taxpayer commences a civil action for refund under section 7422, until the decision in the refund action becomes final).

(e) LIMITATIONS PERIOD.—

(1) IN GENERAL.—Any notice to a taxpayer under subsection (a) shall be mailed before the expiration of the period prescribed by section 6501 (relating to the period of limitations on assessment).

(2) SUSPENSION WHEN SECRETARY MAILS NOTICE OF ADJUSTMENT.—If the Secretary mails a notice of adjustment to the taxpayer for a taxable year, the period of limitations on the making of assessments shall be suspended for the period during which the Secretary is prohibited from making the assessment (and, in any event, if a proceeding in respect of the notice of adjustment is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for 60 days thereafter.

(3) RESTRICTIONS ON ASSESSMENT.—Except as otherwise provided in section 6851, 6852, or 6861, no assessment of a deficiency with respect to any tax imposed by subtitle A attributable to any item (other than a partnership item or any item affected by a partnership item) shall be made—

(A) until the expiration of the applicable 90-day or 150-day period set forth in subsection (c) for filing a petition with the Tax Court, or

(B) if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final.

(f) FURTHER NOTICES OF ADJUSTMENT RESTRICTED.—If the Secretary mails a notice of adjustment to the taxpayer for a taxable year and the taxpayer files a petition with the Tax Court within the time prescribed in subsection (c), the Secretary may not mail another such notice to the taxpayer with respect to the same taxable year in the absence of a showing of fraud, malfeasance, or misrepresentation of a material fact.

(g) COORDINATION WITH OTHER PROCEEDINGS UNDER THIS SUBCHAPTER.—

(1) IN GENERAL.—The treatment of any item that has been determined pursuant to subsection (c) or (d) shall be taken into account in determining the amount of any computational adjustment that is made in connection with a partnership proceeding under this subchapter (other than under this section), or the amount of any deficiency attributable to affected items in a proceeding under section 6230(a)(2), for the taxable year involved. Notwithstanding any other law or rule of law pertaining to the period of limitations on the making of assessments, for purposes of the preceding sentence, any adjustment made in accordance with this section shall be taken into account regardless of whether any assessment has been made with respect to such adjustment.

(2) SPECIAL RULE IN CASE OF COMPUTATIONAL ADJUSTMENT.—In the case of a computational adjustment that is made in connection with a partnership proceeding under this subchapter (other than under this section), the provisions of paragraph (1) shall apply only if the computational adjustment is made within the period prescribed by section 6229 for assessing any tax under subtitle A which is attributable to any partnership item or affected item for the taxable year involved.

(3) CONVERSION TO DEFICIENCY PROCEEDING.—If—

(A) after the notice referred to in subsection (a) is mailed to a taxpayer for a taxable year but before the expiration of the period for filing a petition with the Tax Court under subsection (c) (or, if a petition is filed with the Tax Court, before the Tax Court makes a declaration for that taxable year), the treatment of any partnership item for the taxable year is finally determined, or any such item ceases to be a partnership item pursuant to section 6231(b), and

(B) as a result of that final determination or cessation, a deficiency can be determined with respect to the items that are the subject of the notice of adjustment,

the notice of adjustment shall be treated as a notice of deficiency under section 6212 and any petition filed in respect of the notice shall be treated as an action brought under section 6213.

(4) FINALLY DETERMINED.—For purposes of this subsection, the treatment of partnership items shall be treated as finally determined if—

(A) the Secretary enters into a settlement agreement (within the meaning of section 6224) with the taxpayer regarding such items,

(B) a notice of final partnership administrative adjustment has been issued and—

(i) no petition has been filed under section 6226 and the time for doing so has expired, or

(ii) a petition has been filed under section 6226 and the decision of the court has become final, or

(C) the period within which any tax attributable to such items may be assessed against the taxpayer has expired.

(h) SPECIAL RULES IF SECRETARY INCORRECTLY DETERMINES APPLICABLE PROCEDURE.—

(1) SPECIAL RULE IF SECRETARY ERRONEOUSLY MAILS NOTICE OF ADJUSTMENT.—If the Secretary erroneously determines that subchapter B does not apply to a taxable year of a taxpayer and consistent with that determination timely mails a notice of adjustment to the taxpayer pursuant to subsection (a) of this section, the notice of adjustment shall be treated as a notice of deficiency under section 6212 and any petition that is filed in respect of the notice shall be treated as an action brought under section 6213.

(2) SPECIAL RULE IF SECRETARY ERRONEOUSLY MAILS NOTICE OF DEFICIENCY.—If the Secretary erroneously determines that subchapter B applies to a taxable year of a taxpayer and consistent with that determination timely mails a notice of deficiency to the taxpayer pursuant to section 6212, the notice of deficiency shall be treated as a notice of adjustment under subsection (a) and any petition that is filed in respect of the notice shall be treated as an action brought under subsection (c).

* * *

[CCH Explanation at ¶ 431. Committee Reports at ¶ 12,315.]

Amendment Notes

Act Sec. 1231(a) amended subchapter C of chapter 63 by adding at the end a new Code Sec. 6234 to read as above.

The above amendment applies to partnership tax years ending after the date of the enactment of this Act.

[¶ 5641] *CODE SEC. 6240. APPLICATION OF SUBCHAPTER.*

(a) GENERAL RULE.—This subchapter shall only apply to electing large partnerships and partners in such partnerships.

(b) COORDINATION WITH OTHER PARTNERSHIP AUDIT PROCEDURES.—

(1) IN GENERAL.—Subchapter C of this chapter shall not apply to any electing large partnership other than in its capacity as a partner in another partnership which is not an electing large partnership.

(2) TREATMENT WHERE PARTNER IN OTHER PARTNERSHIP.—If an electing large partnership is a partner in another partnership which is not an electing large partnership—

(A) subchapter C of this chapter shall apply to items of such electing large partnership which are partnership items with respect to such other partnership, but

(B) any adjustment under such subchapter C shall be taken into account in the manner provided by section 6242.

[CCH Explanation at ¶ 421–427. Committee Reports at ¶ 12,245.]

Amendment Notes

Act Sec. 1222(a) amended chapter 63 by adding at the end a new subchapter D, part I (Code Secs. 6240-6242) to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

[¶ 5643] *CODE SEC. 6241. PARTNER'S RETURN MUST BE CONSISTENT WITH PARTNERSHIP RETURN.*

(a) GENERAL RULE.—A partner of any electing large partnership shall, on the partner's return, treat each partnership item attributable to such partnership in a manner which is consistent with the treatment of such partnership item on the partnership return.

(b) UNDERPAYMENT DUE TO INCONSISTENT TREATMENT ASSESSED AS MATH ERROR.—Any underpayment of tax by a partner by reason of failing to comply with the requirements of subsection (a) shall be assessed and collected in the same manner as if such underpayment were on account of a mathematical or clerical error appearing on the partner's return. Paragraph (2) of section 6213(b) shall not apply to any assessment of an underpayment referred to in the preceding sentence.

(c) ADJUSTMENTS NOT TO AFFECT PRIOR YEAR OF PARTNERS.—

(1) IN GENERAL.—Except as provided in paragraph (2), subsections (a) and (b) shall apply without regard to any adjustment to the partnership item under part II.

(2) CERTAIN CHANGES IN DISTRIBUTIVE SHARE TAKEN INTO ACCOUNT BY PARTNER.—

(A) IN GENERAL.—To the extent that any adjustment under part II involves a change under section 704 in a partner's distributive share of the amount of any partnership item shown on the partnership return, such adjustment shall be taken into account in applying this title to such partner for the partner's taxable year for which such item was required to be taken into account.

(B) COORDINATION WITH DEFICIENCY PROCEDURES.—

(i) IN GENERAL.—Subchapter B shall not apply to the assessment or collection of any underpayment of tax attributable to an adjustment referred to in subparagraph (A).

(ii) ADJUSTMENT NOT PRECLUDED.—Notwithstanding any other law or rule of law, nothing in subchapter B (or in any proceeding under subchapter B) shall preclude the assessment or collection of any underpayment of tax (or the allowance of any credit or refund of any overpayment of tax) attributable to an adjustment referred to in subparagraph (A) and such assessment or collection or allowance (or any notice thereof) shall not preclude any notice, proceeding, or determination under subchapter B.

(C) PERIOD OF LIMITATIONS.—The period for—

(i) assessing any underpayment of tax, or

(ii) filing a claim for credit or refund of any overpayment of tax,

attributable to an adjustment referred to in subparagraph (A) shall not expire before the close of the period prescribed by section 6248 for making adjustments with respect to the partnership taxable year involved.

(D) TIERED STRUCTURES.—If the partner referred to in subparagraph (A) is another partnership or an S corporation, the rules of this paragraph shall also apply to persons holding interests in such partnership or S corporation (as the case may be); except that, if such partner is an electing large partnership, the adjustment referred to in subparagraph (A) shall be taken into account in the manner provided by section 6242.

(d) ADDITION TO TAX FOR FAILURE TO COMPLY WITH SECTION.—

For addition to tax in case of partner's disregard of requirements of this section, see part II of subchapter A of chapter 68.

[CCH Explanation at ¶ 421–427. Committee Reports at ¶ 12,245.]

Amendment Notes

Act Sec. 1222(a) added Code Sec. 6241 to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

[¶ 5645] *CODE SEC. 6242. PROCEDURES FOR TAKING PARTNERSHIP ADJUSTMENTS INTO ACCOUNT.*

(a) ADJUSTMENTS FLOW THROUGH TO PARTNERS FOR YEAR IN WHICH ADJUSTMENT TAKES EFFECT.—

(1) IN GENERAL.—If any partnership adjustment with respect to any partnership item takes effect (within the meaning of subsection (d)(2)) during any partnership taxable year and if an election under paragraph (2) does not apply to such adjustment, such adjustment shall be taken into account in determining the amount of such item for the partnership taxable year in which such adjustment takes effect. In applying this title to any person who is (directly or indirectly) a partner in such

partnership during such partnership taxable year, such adjustment shall be treated as an item actually arising during such taxable year.

(2) PARTNERSHIP LIABLE IN CERTAIN CASES.—If—

(A) a partnership elects under this paragraph to not take an adjustment into account under paragraph (1),

(B) a partnership does not make such an election but in filing its return for any partnership taxable year fails to take fully into account any partnership adjustment as required under paragraph (1), or

(C) any partnership adjustment involves a reduction in a credit which exceeds the amount of such credit determined for the partnership taxable year in which the adjustment takes effect,

the partnership shall pay to the Secretary an amount determined by applying the rules of subsection (b)(4) to the adjustments not so taken into account and any excess referred to in subparagraph (C).

(3) OFFSETTING ADJUSTMENTS TAKEN INTO ACCOUNT.—If a partnership adjustment requires another adjustment in a taxable year after the adjusted year and before the partnership taxable year in which such partnership adjustment takes effect, such other adjustment shall be taken into account under this subsection for the partnership taxable year in which such partnership adjustment takes effect.

(4) COORDINATION WITH PART II.—Amounts taken into account under this subsection for any partnership taxable year shall continue to be treated as adjustments for the adjusted year for purposes of determining whether such amounts may be readjusted under part II.

(b) PARTNERSHIP LIABLE FOR INTEREST AND PENALTIES.—

(1) IN GENERAL.—If a partnership adjustment takes effect during any partnership taxable year and such adjustment results in an imputed underpayment for the adjusted year, the partnership—

(A) shall pay to the Secretary interest computed under paragraph (2), and

(B) shall be liable for any penalty, addition to tax, or additional amount as provided in paragraph (3).

(2) DETERMINATION OF AMOUNT OF INTEREST.—The interest computed under this paragraph with respect to any partnership adjustment is the interest which would be determined under chapter 67—

(A) on the imputed underpayment determined under paragraph (4) with respect to such adjustment,

(B) for the period beginning on the day after the return due date for the adjusted year and ending on the return due date for the partnership taxable year in which such adjustment takes effect (or, if earlier, in the case of any adjustment to which subsection (a)(2) applies, the date on which the payment under subsection (a)(2) is made).

Proper adjustments in the amount determined under the preceding sentence shall be made for adjustments required for partnership taxable years after the adjusted year and before the year in which the partnership adjustment takes effect by reason of such partnership adjustment.

(3) PENALTIES.—A partnership shall be liable for any penalty, addition to tax, or additional amount for which it would have been liable if such partnership had been an individual subject to tax under chapter 1 for the adjusted year and the imputed underpayment determined under paragraph (4) were an actual underpayment (or understatement) for such year.

(4) IMPUTED UNDERPAYMENT.—For purposes of this subsection, the imputed underpayment determined under this paragraph with respect to any partnership adjustment is the underpayment (if any) which would result—

(A) by netting all adjustments to items of income, gain, loss, or deduction and by treating any net increase in income as an underpayment equal to the amount of such net increase multiplied by the highest rate of tax in effect under section 1 or 11 for the adjusted year, and

(B) by taking adjustments to credits into account as increases or decreases (whichever is appropriate) in the amount of tax.

For purposes of the preceding sentence, any net decrease in a loss shall be treated as an increase in income and a similar rule shall apply to a net increase in a loss.

(c) ADMINISTRATIVE PROVISIONS.—

(1) IN GENERAL.—Any payment required by subsection (a)(2) or (b)(1)(A)—

(A) shall be assessed and collected in the same manner as if it were a tax imposed by subtitle C, and

(B) shall be paid on or before the return due date for the partnership taxable year in which the partnership adjustment takes effect.

(2) INTEREST.—For purposes of determining interest, any payment required by subsection (a)(2) or (b)(1)(A) shall be treated as an underpayment of tax.

(3) PENALTIES.—

(A) IN GENERAL.—In the case of any failure by any partnership to pay on the date prescribed therefor any amount required by subsection (a)(2) or (b)(1)(A), there is hereby imposed on such partnership a penalty of 10 percent of the underpayment. For purposes of the preceding sentence, the term "underpayment" means the excess of any payment required under this section over the amount (if any) paid on or before the date prescribed therefor.

(B) ACCURACY-RELATED AND FRAUD PENALTIES MADE APPLICABLE.—For purposes of part II of subchapter A of chapter 68, any payment required by subsection (a)(2) shall be treated as an underpayment of tax.

(d) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) PARTNERSHIP ADJUSTMENT.—The term "partnership adjustment" means any adjustment in the amount of any partnership item of an electing large partnership.

(2) WHEN ADJUSTMENT TAKES EFFECT.—A partnership adjustment takes effect—

(A) in the case of an adjustment pursuant to the decision of a court in a proceeding brought under part II, when such decision becomes final,

(B) in the case of an adjustment pursuant to any administrative adjustment request under section 6251, when such adjustment is allowed by the Secretary, or

(C) in any other case, when such adjustment is made.

(3) ADJUSTED YEAR.—The term "adjusted year" means the partnership taxable year to which the item being adjusted relates.

(4) RETURN DUE DATE.—The term "return due date" means, with respect to any taxable year, the date prescribed for filing the partnership return for such taxable year (determined without regard to extensions).

(5) ADJUSTMENTS INVOLVING CHANGES IN CHARACTER.—Under regulations, appropriate adjustments in the application of this section shall be made for purposes of taking into account partnership adjustments which involve a change in the character of any item of income, gain, loss, or deduction.

(e) PAYMENTS NONDEDUCTIBLE.—No deduction shall be allowed under subtitle A for any payment required to be made by an electing large partnership under this section.

[CCH Explanation at ¶ 421–427. Committee Reports at ¶ 12,245.]

Amendment Notes

Act Sec. 1222(a) added Code Sec. 6242 to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

[¶ 5647] *CODE SEC. 6245. SECRETARIAL AUTHORITY.*

(a) GENERAL RULE.—The Secretary is authorized and directed to make adjustments at the partnership level in any partnership item to the extent necessary to have such item be treated in the manner required.

(b) NOTICE OF PARTNERSHIP ADJUSTMENT.—

(1) IN GENERAL.—If the Secretary determines that a partnership adjustment is required, the Secretary is authorized to send notice of such adjustment to the partnership by certified mail or registered mail. Such notice shall be sufficient if mailed to the partnership at its last known address even if the partnership has terminated its existence.

(2) FURTHER NOTICES RESTRICTED.—If the Secretary mails a notice of a partnership adjustment to any partnership for any partnership taxable year and the partnership files a petition under section 6247 with respect to such notice, in the absence of a showing of fraud, malfeasance, or misrepresentation of a material fact, the Secretary shall not mail another such notice to such partnership with respect to such taxable year.

(3) AUTHORITY TO RESCIND NOTICE WITH PARTNERSHIP CONSENT.—The Secretary may, with the consent of the partnership, rescind any notice of a partnership adjustment mailed to such partnership. Any notice so rescinded shall not be treated as a notice of a partnership adjustment, for purposes of this section, section 6246, and section 6247, and the taxpayer shall have no right to bring a proceeding under

section 6247 with respect to such notice. Nothing in this subsection shall affect any suspension of the running of any period of limitations during any period during which the rescinded notice was outstanding.

[CCH Explanation at ¶ 421–427. Committee Reports at ¶ 12,245.]

Amendment Notes

Act Sec. 1222(a) amended chapter 63 by adding at the end a new subchapter D, part II, subpart A (Code Secs. 6245-6248) to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

[¶ 5649] *CODE SEC. 6246. RESTRICTIONS ON PARTNERSHIP ADJUSTMENTS.*

(a) GENERAL RULE.—Except as otherwise provided in this chapter, no adjustment to any partnership item may be made (and no levy or proceeding in any court for the collection of any amount resulting from such adjustment may be made, begun or prosecuted) before—

(1) the close of the 90th day after the day on which a notice of a partnership adjustment was mailed to the partnership, and

(2) if a petition is filed under section 6247 with respect to such notice, the decision of the court has become final.

(b) PREMATURE ACTION MAY BE ENJOINED.—Notwithstanding section 7421(a), any action which violates subsection (a) may be enjoined in the proper court, including the Tax Court. The Tax Court shall have no jurisdiction to enjoin any action under this subsection unless a timely petition has been filed under section 6247 and then only in respect of the adjustments that are the subject of such petition.

(c) EXCEPTIONS TO RESTRICTIONS ON ADJUSTMENTS.—

(1) ADJUSTMENTS ARISING OUT OF MATH OR CLERICAL ERRORS.—

(A) IN GENERAL.—If the partnership is notified that, on account of a mathematical or clerical error appearing on the partnership return, an adjustment to a partnership item is required, rules similar to the rules of paragraphs (1) and (2) of section 6213(b) shall apply to such adjustment.

(B) SPECIAL RULE.—If an electing large partnership is a partner in another electing large partnership, any adjustment on account of such partnership's failure to comply with the requirements of section 6241(a) with respect to its interest in such other partnership shall be treated as an adjustment referred to in subparagraph (A), except that paragraph (2) of section 6213(b) shall not apply to such adjustment.

(2) PARTNERSHIP MAY WAIVE RESTRICTIONS.—The partnership shall at any time (whether or not a notice of partnership adjustment has been issued) have the right, by a signed notice in writing filed with the Secretary, to waive the restrictions provided in subsection (a) on the making of any partnership adjustment.

(d) LIMIT WHERE NO PROCEEDING BEGUN.—If no proceeding under section 6247 is begun with respect to any notice of a partnership adjustment during the 90-day period described in subsection (a), the amount for which the partnership is liable under section 6242 (and any increase in any partner's liability for tax under chapter 1 by reason of any adjustment under section 6242(a)) shall not exceed the amount determined in accordance with such notice.

[CCH Explanation at ¶ 421–427. Committee Reports at ¶ 12,245.]

Amendment Notes

Act Sec. 1222(a) added Code Sec. 6246 to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

[¶ 5651] *CODE SEC. 6247. JUDICIAL REVIEW OF PARTNERSHIP ADJUSTMENT.*

(a) GENERAL RULE.—Within 90 days after the date on which a notice of a partnership adjustment is mailed to the partnership with respect to any partnership taxable year, the partnership may file a petition for a readjustment of the partnership items for such taxable year with—

(1) the Tax Court,

(2) the district court of the United States for the district in which the partnership's principal place of business is located, or

(3) the Claims Court.

(b) JURISDICTIONAL REQUIREMENT FOR BRINGING ACTION IN DISTRICT COURT OR CLAIMS COURT.—

(1) IN GENERAL.—A readjustment petition under this section may be filed in a district court of the United States or the Claims Court only if the partnership filing the petition deposits with the Secretary, on or before the date the petition is filed, the amount for which the partnership would be liable under section 6242(b) (as of the date of the filing of the petition) if the partnership items were

adjusted as provided by the notice of partnership adjustment. The court may by order provide that the jurisdictional requirements of this paragraph are satisfied where there has been a good faith attempt to satisfy such requirement and any shortfall of the amount required to be deposited is timely corrected.

(2) INTEREST PAYABLE.—Any amount deposited under paragraph (1), while deposited, shall not be treated as a payment of tax for purposes of this title (other than chapter 67).

(c) SCOPE OF JUDICIAL REVIEW.—A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of partnership adjustment relates and the proper allocation of such items among the partners (and the applicability of any penalty, addition to tax, or additional amount for which the partnership may be liable under section 6242(b)).

(d) DETERMINATION OF COURT REVIEWABLE.—Any determination by a court under this section shall have the force and effect of a decision of the Tax Court or a final judgment or decree of the district court or the Claims Court, as the case may be, and shall be reviewable as such. The date of any such determination shall be treated as being the date of the court's order entering the decision.

(e) EFFECT OF DECISION DISMISSING ACTION.—If an action brought under this section is dismissed other than by reason of a rescission under section 6245(b)(3), the decision of the court dismissing the action shall be considered as its decision that the notice of partnership adjustment is correct, and an appropriate order shall be entered in the records of the court.

[CCH Explanation at ¶ 421–427. Committee Reports at ¶ 12,245.]

Amendment Notes

Act Sec. 1222(a) added Code Sec. 6247 to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

[¶ 5653] *CODE SEC. 6248. PERIOD OF LIMITATIONS FOR MAKING ADJUSTMENTS.*

(a) GENERAL RULE.—Except as otherwise provided in this section, no adjustment under this subpart to any partnership item for any partnership taxable year may be made after the date which is 3 years after the later of—

(1) the date on which the partnership return for such taxable year was filed, or

(2) the last day for filing such return for such year (determined without regard to extensions).

(b) EXTENSION BY AGREEMENT.—The period described in subsection (a) (including an extension period under this subsection) may be extended by an agreement entered into by the Secretary and the partnership before the expiration of such period.

(c) SPECIAL RULE IN CASE OF FRAUD, ETC.—

(1) FALSE RETURN.—In the case of a false or fraudulent partnership return with intent to evade tax, the adjustment may be made at any time.

(2) SUBSTANTIAL OMISSION OF INCOME.—If any partnership omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in its return, subsection (a) shall be applied by substituting "6 years" for "3 years".

(3) NO RETURN.—In the case of a failure by a partnership to file a return for any taxable year, the adjustment may be made at any time.

(4) RETURN FILED BY SECRETARY.—For purposes of this section, a return executed by the Secretary under subsection (b) of section 6020 on behalf of the partnership shall not be treated as a return of the partnership.

(d) SUSPENSION WHEN SECRETARY MAILS NOTICE OF ADJUSTMENT.—If notice of a partnership adjustment with respect to any taxable year is mailed to the partnership, the running of the period specified in subsection (a) (as modified by the other provisions of this section) shall be suspended—

(1) for the period during which an action may be brought under section 6247 (and, if a petition is filed under section 6247 with respect to such notice, until the decision of the court becomes final), and

(2) for 1 year thereafter.

* * *

[CCH Explanation at ¶ 421–427. Committee Reports at ¶ 12,245.]

Amendment Notes

Act Sec. 1222(a) added Code Sec. 6248 to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

[¶ 5655] *CODE SEC. 6251. ADMINISTRATIVE ADJUSTMENT REQUESTS.*

(a) GENERAL RULE.—A partnership may file a request for an administrative adjustment of partnership items for any partnership taxable year at any time which is—

(1) within 3 years after the later of—

(A) the date on which the partnership return for such year is filed, or

(B) the last day for filing the partnership return for such year (determined without regard to extensions), and

(2) before the mailing to the partnership of a notice of a partnership adjustment with respect to such taxable year.

(b) SECRETARIAL ACTION.—If a partnership files an administrative adjustment request under subsection (a), the Secretary may allow any part of the requested adjustments.

(c) SPECIAL RULE IN CASE OF EXTENSION UNDER SECTION 6248.—If the period described in section 6248(a) is extended pursuant to an agreement under section 6248(b), the period prescribed by subsection (a)(1) shall not expire before the date 6 months after the expiration of the extension under section 6248(b).

[CCH Explanation at ¶ 421–427. Committee Reports at ¶ 12,245.]

Amendment Notes

Act Sec. 1222(a) amended chapter 63 by adding at the end a new subchapter D, part II, subpart B (Code Secs. 6251-6252) to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

[¶ 5657] *CODE SEC. 6252. JUDICIAL REVIEW WHERE ADMINISTRATIVE ADJUSTMENT REQUEST IS NOT ALLOWED IN FULL.*

(a) IN GENERAL.—If any part of an administrative adjustment request filed under section 6251 is not allowed by the Secretary, the partnership may file a petition for an adjustment with respect to the partnership items to which such part of the request relates with—

(1) the Tax Court,

(2) the district court of the United States for the district in which the principal place of business of the partnership is located, or

(3) the Claims Court.

(b) PERIOD FOR FILING PETITION.—A petition may be filed under subsection (a) with respect to partnership items for a partnership taxable year only—

(1) after the expiration of 6 months from the date of filing of the request under section 6251, and

(2) before the date which is 2 years after the date of such request.

The 2-year period set forth in paragraph (2) shall be extended for such period as may be agreed upon in writing by the partnership and the Secretary.

(c) COORDINATION WITH SUBPART A.—

(1) NOTICE OF PARTNERSHIP ADJUSTMENT BEFORE FILING OF PETITION.—No petition may be filed under this section after the Secretary mails to the partnership a notice of a partnership adjustment for the partnership taxable year to which the request under section 6251 relates.

(2) NOTICE OF PARTNERSHIP ADJUSTMENT AFTER FILING BUT BEFORE HEARING OF PETITION.—If the Secretary mails to the partnership a notice of a partnership adjustment for the partnership taxable year to which the request under section 6251 relates after the filing of a petition under this subsection but before the hearing of such petition, such petition shall be treated as an action brought under section 6247 with respect to such notice, except that subsection (b) of section 6247 shall not apply.

(3) NOTICE MUST BE BEFORE EXPIRATION OF STATUTE OF LIMITATIONS.—A notice of a partnership adjustment for the partnership taxable year shall be taken into account under paragraphs (1) and (2) only if such notice is mailed before the expiration of the period prescribed by section 6248 for making adjustments to partnership items for such taxable year.

(d) SCOPE OF JUDICIAL REVIEW.—Except in the case described in paragraph (2) of subsection (c), a court with which a petition is filed in accordance with this section shall have jurisdiction to determine only those partnership items to which the part of the request under section 6251 not allowed by the Secretary relates and those items with respect to which the Secretary asserts adjustments as offsets to the adjustments requested by the partnership.

(e) DETERMINATION OF COURT REVIEWABLE.—Any determination by a court under this section shall have the force and effect of a decision of the Tax Court or a final judgment or decree of the district court or the

Claims Court, as the case may be, and shall be reviewable as such. The date of any such determination shall be treated as being the date of the court's order entering the decision.

[CCH Explanation at ¶ 421–427. Committee Reports at ¶ 12,245.]

Amendment Notes

Act Sec. 1222(a) added Code Sec. 6252 to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

[¶ 5659] *CODE SEC. 6255. DEFINITIONS AND SPECIAL RULES.*

(a) DEFINITIONS.—For purposes of this subchapter—

(1) ELECTING LARGE PARTNERSHIP.—The term "electing large partnership" has the meaning given to such term by section 775.

(2) PARTNERSHIP ITEM.—The term "partnership item" has the meaning given to such term by section 6231(a)(3).

(b) PARTNERS BOUND BY ACTIONS OF PARTNERSHIP, ETC.—

(1) DESIGNATION OF PARTNER.—Each electing large partnership shall designate (in the manner prescribed by the Secretary) a partner (or other person) who shall have the sole authority to act on behalf of such partnership under this subchapter. In any case in which such a designation is not in effect, the Secretary may select any partner as the partner with such authority.

(2) BINDING EFFECT.—An electing large partnership and all partners of such partnership shall be bound—

(A) by actions taken under this subchapter by the partnership, and

(B) by any decision in a proceeding brought under this subchapter.

(c) PARTNERSHIPS HAVING PRINCIPAL PLACE OF BUSINESS OUTSIDE THE UNITED STATES.—For purposes of sections 6247 and 6252, a principal place of business located outside the United States shall be treated as located in the District of Columbia.

(d) TREATMENT WHERE PARTNERSHIP CEASES TO EXIST.—If a partnership ceases to exist before a partnership adjustment under this subchapter takes effect, such adjustment shall be taken into account by the former partners of such partnership under regulations prescribed by the Secretary.

(e) DATE DECISION BECOMES FINAL.—For purposes of this subchapter, the principles of section 7481(a) shall be applied in determining the date on which a decision of a district court or the Claims Court becomes final.

(f) PARTNERSHIPS IN CASES UNDER TITLE 11 OF THE UNITED STATES CODE.—

(1) SUSPENSION OF PERIOD OF LIMITATIONS ON MAKING ADJUSTMENT, ASSESSMENT, OR COLLECTION.—The running of any period of limitations provided in this subchapter on making a partnership adjustment (or provided by section 6501 or 6502 on the assessment or collection of any amount required to be paid under section 6242) shall, in a case under title 11 of the United States Code, be suspended during the period during which the Secretary is prohibited by reason of such case from making the adjustment (or assessment or collection) and—

(A) for adjustment or assessment, 60 days thereafter, and

(B) for collection, 6 months thereafter.

A rule similar to the rule of section 6213(f)(2) shall apply for purposes of section 6246.

(2) SUSPENSION OF PERIOD OF LIMITATION FOR FILING FOR JUDICIAL REVIEW.—The running of the period specified in section 6247(a) or 6252(b) shall, in a case under title 11 of the United States Code, be suspended during the period during which the partnership is prohibited by reason of such case from filing a petition under section 6247 or 6252 and for 60 days thereafter.

(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this subchapter, including regulations—

(1) to prevent abuse through manipulation of the provisions of this subchapter, and

(2) providing that this subchapter shall not apply to any case described in section 6231(c)(1) (or the regulations prescribed thereunder) where the application of this subchapter to such a case would interfere with the effective and efficient enforcement of this title.

In any case to which this subchapter does not apply by reason of paragraph (2), rules similar to the rules of sections 6229(f) and 6255(f) shall apply.

* * *

[CCH Explanation at ¶ 421–427. Committee Reports at ¶ 12,245.]

Amendment Notes

Act Sec. 1222(a) amended chapter 63 by adding at the end a new subchapter D, part III (Code Sec. 6255) to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

[Caution: Code Sec. 6311, as added by Act Sec. 1205(a) of the Taxpayer Relief Act of 1997, is effective on the day 9 months after the date of the enactment of the Act.—CCH.]

[¶ 5661] *CODE SEC. 6311. PAYMENT OF TAX BY COMMERCIALLY ACCEPTABLE MEANS.*

(a) AUTHORITY TO RECEIVE.—It shall be lawful for the Secretary to receive for internal revenue taxes (or in payment for internal revenue stamps) any commercially acceptable means that the Secretary deems appropriate to the extent and under the conditions provided in regulations prescribed by the Secretary.

(b) ULTIMATE LIABILITY.—If a check, money order, or other method of payment, including payment by credit card, debit card, or charge card so received is not duly paid, or is paid and subsequently charged back to the Secretary, the person by whom such check, or money order, or other method of payment has been tendered shall remain liable for the payment of the tax or for the stamps, and for all legal penalties and additions, to the same extent as if such check, money order, or other method of payment had not been tendered.

(c) LIABILITY OF BANKS AND OTHERS.—If any certified, treasurer's, or cashier's check (or other guaranteed draft), or any money order, or any other means of payment that has been guaranteed by a financial institution (such as a credit card, debit card, or charge card transaction which has been guaranteed expressly by a financial institution) so received is not duly paid, the United States shall, in addition to its right to exact payment from the party originally indebted therefor, have a lien for—

(1) the amount of such check (or draft) upon all assets of the financial institution on which drawn,

(2) the amount of such money order upon all the assets of the issuer thereof, or

(3) the guaranteed amount of any other transaction upon all the assets of the institution making such guarantee,

and such amount shall be paid out of such assets in preference to any other claims whatsoever against such financial institution, issuer, or guaranteeing institution, except the necessary costs and expenses of administration and the reimbursement of the United States for the amount expended in the redemption of the circulating notes of such financial institution.

(d) PAYMENT BY OTHER MEANS.—

(1) AUTHORITY TO PRESCRIBE REGULATIONS.—The Secretary shall prescribe such regulations as the Secretary deems necessary to receive payment by commercially acceptable means, including regulations that—

(A) specify which methods of payment by commercially acceptable means will be acceptable,

(B) specify when payment by such means will be considered received,

(C) identify types of nontax matters related to payment by such means that are to be resolved by persons ultimately liable for payment and financial intermediaries, without the involvement of the Secretary, and

(D) ensure that tax matters will be resolved by the Secretary, without the involvement of financial intermediaries.

(2) AUTHORITY TO ENTER INTO CONTRACTS.—Notwithstanding section 3718(f) of title 31, United States Code, the Secretary is authorized to enter into contracts to obtain services related to receiving payment by other means where cost beneficial to the Government. The Secretary may not pay any fee or provide any other consideration under such contracts.

(3) SPECIAL PROVISIONS FOR USE OF CREDIT CARDS.—If use of credit cards is accepted as a method of payment of taxes pursuant to subsection (a)—

(A) a payment of internal revenue taxes (or a payment for internal revenue stamps) by a person by use of a credit card shall not be subject to section 161 of the Truth in Lending Act (15 U.S.C. 1666), or to any similar provisions of State law, if the error alleged by the person is an error relating to the underlying tax liability, rather than an error relating to the credit card

account such as a computational error or numerical transposition in the credit card transaction or an issue as to whether the person authorized payment by use of the credit card,

(B) a payment of internal revenue taxes (or a payment for internal revenue stamps) shall not be subject to section 170 of the Truth in Lending Act (15 U.S.C. 1666i), or to any similar provisions of State law,

(C) a payment of internal revenue taxes (or a payment for internal revenue stamps) by a person by use of a debit card shall not be subject to section 908 of the Electronic Fund Transfer Act (15 U.S.C. 1693f), or to any similar provisions of State law, if the error alleged by the person is an error relating to the underlying tax liability, rather than an error relating to the debit card account such as a computational error or numerical transposition in the debit card transaction or an issue as to whether the person authorized payment by use of the debit card,

(D) the term "creditor" under section 103(f) of the Truth in Lending Act (15 U.S.C. 1602(f)) shall not include the Secretary with respect to credit card transactions in payment of internal revenue taxes (or payment for internal revenue stamps), and

(E) notwithstanding any other provision of law to the contrary, in the case of payment made by credit card or debit card transaction of an amount owed to a person as the result of the correction of an error under section 161 of the Truth in Lending Act (15 U.S.C. 1666) or section 908 of the Electronic Fund Transfer Act (15 U.S.C. 1693f), the Secretary is authorized to provide such amount to such person as a credit to that person's credit card or debit card account through the applicable credit card or debit card system.

(e) Confidentiality of Information.—

(1) In general.—Except as otherwise authorized by this subsection, no person may use or disclose any information relating to credit or debit card transactions obtained pursuant to section 6103(k)(8) other than for purposes directly related to the processing of such transactions, or the billing or collection of amounts charged or debited pursuant thereto.

(2) Exceptions.—

(A) Debit or credit card issuers or others acting on behalf of such issuers may also use and disclose such information for purposes directly related to servicing an issuer's accounts.

(B) Debit or credit card issuers or others directly involved in the processing of credit or debit card transactions or the billing or collection of amounts charged or debited thereto may also use and disclose such information for purposes directly related to—

(i) statistical risk and profitability assessment;

(ii) transferring receivables, accounts, or interest therein;

(iii) auditing the account information;

(iv) complying with Federal, State, or local law; and

(v) properly authorized civil, criminal, or regulatory investigation by Federal, State, or local authorities.

(3) Procedures.—Use and disclosure of information under this paragraph shall be made only to the extent authorized by written procedures promulgated by the Secretary.

(4) Cross reference.—

For provision providing for civil damages for violation of paragraph (1), see section 7431.

* * *

[CCH Explanation at ¶ 1111. Committee Reports at ¶ 12,140.]

Amendment Notes

Act Sec. 1205(a) amended Code Sec. 6311 to read as above. Prior to amendment, Code Sec. 6311 read as follows:

SEC. 6311. PAYMENT BY CHECK OR MONEY ORDER.

(a) Authority To Receive.—It shall be lawful for the Secretary to receive for internal revenue taxes, or in payment for internal revenue stamps, checks or money orders, to the extent and under the conditions provided in regulations prescribed by the Secretary.

(b) Check or Money Order Unpaid.—

(1) Ultimate liability.—If a check or money order so received is not duly paid, the person by whom such check or money order has been tendered shall remain liable for the payment of the tax or for the stamps, and for all legal penalties and additions, to the same extent as if such check or money order had not been tendered.

(2) Liability of banks and others.—If any certified, treasurer's, or cashier's check (or other guaranteed draft) or any money order so received is not duly paid, the United States shall, in addition to its right to exact payment from the party originally indebted therefor, have a lien for the amount of such check (or draft) upon all the assets of the financial institution on which drawn or for the amount of

such money order upon all the assets of the issuer thereof; and such amount shall be paid out of such assets in preference to any other claims whatsoever against such financial institution or issuer except the necessary costs and expenses of administration and the reimbursement of the United States for the amount expended in the redemption of the circulating notes of such financial institution.

The above amendment takes effect on the day 9 months after the date of the enactment of this Act.

[¶ 5663] CODE SEC. 6331. LEVY AND DISTRAINT.

* * *

(h) CONTINUING LEVY ON CERTAIN PAYMENTS.—

(1) IN GENERAL.—The effect of a levy on specified payments to or received by a taxpayer shall be continuous from the date such levy is first made until such levy is released. Notwithstanding section 6334, such continuous levy shall attach to up to 15 percent of any specified payment due to the taxpayer.

(2) SPECIFIED PAYMENT.—For the purposes of paragraph (1), the term "specified payment" means—

(A) any Federal payment other than a payment for which eligibility is based on the income or assets (or both) of a payee,

(B) any payment described in paragraph (4), (7), (9), or (11) of section 6334(a), and

(C) any annuity or pension payment under the Railroad Retirement Act or benefit under the Railroad Unemployment Insurance Act.

Amendment Notes

Act Sec. 1024(a)(1)-(2) amended Code Sec. 6331 by redesignating subsection (h) as subsection (i), and by inserting after subsection (g) a new subsection (h) to read as above.

The above amendment applies to levies issued after the date of the enactment of this Act.

(i) CROSS REFERENCES.—

* * *

[CCH Explanation at ¶ 1019. Committee Reports at ¶ 11,230.]

Amendment Notes

Act Sec. 1024(a)(1) amended Code Sec. 6331 by redesignating subsection (h) as subsection (i).

The above amendment applies to levies issued after the date of the enactment of this Act.

[¶ 5665] CODE SEC. 6334. PROPERTY EXEMPT FROM LEVY.

(a) ENUMERATION.—There shall be exempt from levy—

* * *

(13) PRINCIPAL RESIDENCE EXEMPT IN ABSENCE OF CERTAIN APPROVAL OR JEOPARDY.—Except to the extent provided in subsection (e), the principal residence of the taxpayer (within the meaning of *section 121*).

* * *

Amendment Notes

Act Sec. 312(d)(1) amended Code Sec. 6334(a)(13) by striking "section 1034" and inserting "section 121".

The above amendment applies to sales and exchanges after May 6, 1997.

(f) LEVY ALLOWED ON CERTAIN SPECIFIED PAYMENTS.—Any payment described in subparagraph (B) or (C) of section 6331(h)(2) shall not be exempt from levy if the Secretary approves the levy thereon under section 6331(h).

Amendment Notes

Act Sec. 1025(a) amended Code Sec. 6334 by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) a new subsection (f) to read as above.

The above amendment applies to levies issued after the date of the enactment of this Act.

(g) INFLATION ADJUSTMENT.—

* * *

[CCH Explanation at ¶ 129 and 1022. Committee Reports at ¶ 10,315 and 11,235.]

Amendment Notes

Act Sec. 1025(a) amended Code Sec. 6334 by redesignating subsection (f) as subsection (g).

The above amendment applies to levies issued after the date of the enactment of this Act.

[¶ 5666] CODE SEC. 6402. AUTHORITY TO MAKE CREDITS OR REFUNDS.

(a) GENERAL RULE.—In the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against

any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsections *(c) and (d)* refund any balance to such person.

* * *

Amendment Notes

Balanced Budget Act

Act Sec. 5514(a)(1) struck the changes made by Act Sec. 110(l)(7)(A) of the Personal Responsibility and Work Opportunity Act of 1996 (P.L. 104-193), which amended Code Sec. 6402(a) by striking "(c) or (d)" each place it appeared and inserting "(c), (d), or (e)". Thus, the provisions of law amended by such section are restored as if such section had not been enacted.

The above amendment is effective on July 1, 1997.

(e) *[Stricken.]*

Amendment Notes

Balanced Budget Act

Act Sec. 5514(a)(1) struck the change made by Act Sec. 110(l)(7)(C) of the Personal Responsibility and Work Opportunity Act of 1996 (P.L. 104-193), which added a new Code Sec. 6402(e). Thus, subsection (e) of Code Sec. 6402 never took effect, and Code Sec. 6402 is restored as if Act Sec. 110(l)(7)(C) was never enacted. Prior to the amendment's being stricken, Code Sec. 6402(e) read as follows:

(e) COLLECTION OF OVERPAYMENTS UNDER TITLE IV-A OF THE SOCIAL SECURITY ACT.—The amount of any overpayment to be refunded to the person making the overpayment shall be reduced (after reductions pursuant to subsections (c) and (d), but before a credit against future liability for an internal revenue tax) in accordance with section 405(e) of the Social Security Act (concerning recovery of overpayments to individuals under State plans approved under part A of title IV of such Act).

The above amendment is effective on July 1, 1997.

(e) REVIEW OF REDUCTIONS.—No court of the United States shall have jurisdiction to hear any action, whether legal or equitable, brought to restrain or review a reduction authorized by subsection (c) or (d). No such reduction shall be subject to review by the Secretary in an administrative proceeding. No action brought against the United States to recover the amount of any such reduction shall be considered to be a suit for refund of tax. This subsection does not preclude any legal, equitable, or administrative action against the Federal agency to which the amount of such reduction was paid or any such action against the Commissioner of Social Security which is otherwise available with respect to recoveries of overpayments of benefits under section 204 of the Social Security Act.

Amendment Notes

Balanced Budget Act

Act Sec. 5514(a)(1) struck the change made by Act Sec. 110(l)(7)(B) of the Personal Responsibility and Work Opportunity Act of 1996 (P.L. 104-193), which redesignated Code Sec. 6402(e) as Code Sec. 6402(f). The provision of law added by P.L. 104-193 is restored as if Act Sec. 110(l)(7)(B) had not been enacted. Thus, subsection (f) of Code Sec. 6402 is now designated as subsection (e) of Code Sec. 6402.

The above amendment is effective on July 1, 1997.

(f) FEDERAL AGENCY.—For purposes of this section, the term "Federal agency" means a department, agency, or instrumentality of the United States, and includes a Government corporation (as such term is defined in section 103 of title 5, United States Code).

Amendment Notes

Balanced Budget Act

Act Sec. 5514(a)(1) struck the change made by Act Sec. 110(l)(7)(B) of the Personal Responsibility and Work Opportunity Act of 1996 (P.L. 104-193), which redesignated Code Sec. 6402(f) as Code Sec. 6402(g). The provision of law added by P.L. 104-193 is restored as if Act Sec. 110(l)(7)(B) had not been enacted. Thus, subsection (g) of Code Sec. 6402 is now designated as subsection (f) of Code Sec. 6402.

The above amendment is effective on July 1, 1997.

(g) TREATMENT OF PAYMENTS TO STATES.—The Secretary may provide that, for purposes of determining interest, the payment of any amount withheld under subsection (c) to a State shall be treated as a payment to the person or persons making the overpayment.

Amendment Notes

Balanced Budget Act

Act Sec. 5514(a)(1) struck the change made by Act Sec. 110(l)(7)(B) of the Personal Responsibility and Work Opportunity Act of 1996 (P.L. 104-193), which redesignated Code Sec. 6402(g) as Code Sec. 6402(h). The provision of law added by P.L. 104-193 is restored as if Act Sec. 110(l)(7)(B) had not been enacted. Thus, subsection (h) of Code Sec. 6402 is now designated as subsection (g) of Code Sec. 6402.

The above amendment is effective on July 1, 1997.

(h) CROSS REFERENCE.—For procedures relating to agency notification of the Secretary, see section 3721 of title 31, United States Code.

Amendment Notes

Balanced Budget Act

Act Sec. 5514(a)(1) struck the change made by Act Sec. 110(l)(7)(B) of the Personal Responsibility and Work Opportunity Act of 1996 (P.L. 104-193), which redesignated Code Sec. 6402(h) as Code Sec. 6402(i). The provision of law added by P.L. 104-193 is restored as if Act Sec. 110(l)(7)(B) had not been enacted. Thus, subsection (i) of Code Sec. 6402 is now designated as subsection (h) of Code Sec. 6402.

The above amendment is effective on July 1, 1997.

(i) REFUNDS TO CERTAIN FIDUCIARIES OF INSOLVENT MEMBERS OF AFFILIATED GROUPS.—Notwithstanding any other provision of law, in the case of an insolvent corporation which is a member of an affiliated group of corporations filing a consolidated return for any taxable year and which is subject to a statutory or court-appointed fiduciary, the Secretary may by regulation provide that any refund for

such taxable year may be paid on behalf of such insolvent corporation to such fiduciary to the extent that the Secretary determines that the refund is attributable to losses or credits of such insolvent corporation.

* * *

Amendment Notes

Balanced Budget Act

Act Sec. 5514(a)(1) struck the change made by Act Sec. 110(l)(7)(B) of the Personal Responsibility and Work Opportunity Act of 1996 (P.L. 104-193), which redesignated Code Sec. 6402(i) as Code Sec. 6402(j). The provision of law added by P.L. 104-193 is restored as if Act Sec. 110(l)(7)(B) had not been enacted. Thus, subsection (j) of Code Sec. 6402 is now designated as subsection (i) of Code Sec. 6402.

The above amendment is effective on July 1, 1997.

[¶ 5667] CODE SEC. 6416. CERTAIN TAXES ON SALES AND SERVICES.

(a) CONDITION TO ALLOWANCE.—

* * *

(4) WHOLESALE DISTRIBUTORS TO ADMINISTER CREDITS AND REFUNDS OF GASOLINE TAX.—

* * *

(B) WHOLESALE DISTRIBUTOR.—For purposes of subparagraph (A), the term "wholesale distributor" has the meaning given such term by section 4093(b)(2) (determined by substituting "any gasoline taxable under section 4081" for "aviation fuel" therein). *Such term includes any person who makes retail sales of gasoline at 10 or more retail motor fuel outlets.*

Amendment Notes

Act Sec. 905(a) amended Code Sec. 6416(a)(4)(B) by adding at the end a new sentence to read as above.

The above amendment applies to sales after the date of the enactment of this Act.

(b) SPECIAL CASES IN WHICH TAX PAYMENTS CONSIDERED OVERPAYMENTS.—Under regulations prescribed by the Secretary, credit or refund (without interest) shall be allowed or made in respect of the overpayments determined under the following paragraphs:

* * *

(2) SPECIFIED USES AND RESALES.—The tax paid under chapter 32 (or under subsection (a) or (d) of section 4041 in respect of sales or under section 4051) in respect of any article shall be deemed to be an overpayment if such article was, by any person—

* * *

[*Caution: The flush paragraph of Code Sec. 6416(b)(2), below, as amended by Act Sec. 1032(e)(6) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

Subparagraphs (C) and (D) shall not apply in the case of any tax paid under section 4064. This paragraph shall not apply in the case of any tax imposed under section 4041(a)(1) or 4081 on diesel fuel *or kerosene* and any tax paid under section 4091 or 4121. In the case of the tax imposed by section 4131, subparagraphs (B), (C), and (D) shall not apply and subparagraph (A) shall apply only if the use of the exported vaccine meets such requirements as the Secretary may by regulations prescribe.

* * *

Amendment Notes

Act Sec. 1032(e)(6) amended the flush paragraph of Code Sec. 6416(b)(2) by inserting "or kerosene" after "diesel fuel".

The above amendment is effective on July 1, 1998.

(d) CREDIT ON RETURNS.—Any person entitled to a refund of tax imposed by chapter 31 or 32, paid to the Secretary may, instead of filing a claim for refund, take credit therefor against taxes imposed by such chapter due on any subsequent return. The preceding sentence shall not apply to the tax imposed by section 4081 in the case of refunds described in section 4081(e) *or to the tax imposed by section 4091 in the case of refunds described in section 4091(d).*

* * *

[CCH Explanation at ¶ 1211, 1219 and 1227. Committee Reports at ¶ 10,535, 11,285 and 12,875.]

Amendment Notes

Act Sec. 1436(b) amended Code Sec. 6416(d) by inserting before the period "or to the tax imposed by section 4091 in the case of refunds described in section 4091(d)" in the last sentence.

The above amendment applies to fuel acquired by the producer after September 30, 1997.

[¶ 5669] CODE SEC. 6421. GASOLINE USED FOR CERTAIN NONHIGHWAY PURPOSES, USED BY LOCAL TRANSIT SYSTEMS, OR SOLD FOR CERTAIN EXEMPT PURPOSES.

* * *

(e) DEFINITIONS.—For purposes of this section—

* * *

(2) OFF-HIGHWAY BUSINESS USE.—

* * *

(B) USES IN BOATS.—

(i) IN GENERAL.—Except as otherwise provided in this subparagraph, the term "off-highway business use" does not include any use in a motorboat.

(ii) FISHERIES AND WHALING.—The term "off-highway business use" shall include any use in a vessel employed in the fisheries or in the whaling business.

(iii) *[Stricken.]*

(iv) *[Stricken.]*

* * *

[CCH Explanation at ¶ 1209. Committee Reports at ¶ 10,520.]

Amendment Notes

Act Sec. 902(a) amended Code Sec. 6421(e)(2)(B) by striking clauses (iii) and (iv). Prior to being stricken, Code Sec. 6421(e)(2)(B)(iii)-(iv) read as follows:

(iii) EXCEPTION FOR DIESEL FUEL.—The term "off-highway business use" shall include the use of diesel fuel in a boat in the active conduct of—

(I) a trade or business of commercial fishing or transporting persons or property for compensation or hire, and

(II) except as provided in clause (iv), any other trade or business.

(iv) NONCOMMERCIAL BOATS.—In the case of a boat used predominantly in any activity which is of a type generally considered to constitute entertainment, amusement, or recreation, clause (iii)(II) shall not apply to—

(I) the taxes under sections 4041(a)(1) and 4081 for the period after December 31, 1993, and before January 1, 2000, and

(II) so much of the tax under sections 4041(a)(1) and 4081 as does not exceed 4.3 cents per gallon for the period after December 31, 1999.

The above amendment is effective on January 1, 1998.

[¶ 5671] CODE SEC. 6422. CROSS REFERENCES.

* * *

(5) For refund or redemption of stamps, see chapter 69.

(6) For abatement, credit, or refund in case of jeopardy assessments, see chapter 70.

(7) For treatment of certain overpayments as having been refunded, in connection with sale of surplus war-built vessels, see section 9(b)(8) of the Merchant Ship Sales Act of 1946 (50 U.S.C. App. 1742).

(8) For restrictions on transfers and assignments of claims against the United States, see section 3727 of title 31, United States Code.

(9) For set-off of claims against amounts due the United States, see section 3728 of title 31, United States Code.

(10) For special provisions relating to alcohol and tobacco taxes, see subtitle E.

(11) For credit or refund in case of deficiency dividends paid by a regulated investment company or real estate investment trust, see section 860.

(12) For special rules in the case of a credit or refund attributable to partnership items, see secton 6227 and subsections (c) and (d) of section 6230.

* * *

[CCH Explanation at ¶ 969. Committee Reports at ¶ 11,735.]

Amendment Notes

Act Sec. 1131(c)[(d)](3) amended Code Sec. 6422 by striking paragraph (5) and by redesignating paragraphs (6) through (13) as paragraphs (5) through (12), respectively. Prior to being stricken, Code Sec. 6422(5) read as follows:

(5) For abatement or refund of tax on transfers to avoid income tax, see section 1494(b).

The above amendment is effective on the date of the enactment of this Act.

[¶ 5673] CODE SEC. 6427. FUELS NOT USED FOR TAXABLE PURPOSES.

* * *

[*Caution: Code Sec. 6427(f), below, as amended by Act Sec. 1032(e)(7)-(8) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

(f) GASOLINE, DIESEL FUEL, *KEROSENE*, AND AVIATION FUEL USED TO PRODUCE CERTAIN ALCOHOL FUELS.—

(1) IN GENERAL.—Except as provided in subsection (k), if any gasoline, diesel fuel, *kerosene*, or aviation fuel on which tax was imposed by section 4081 or 4091 at the regular tax rate is used by any person in producing a mixture described in section 4081(c) or 4091(c)(1)(A) (as the case may be) which is sold or used in such person's trade or business the Secretary shall pay (without interest) to such person an amount equal to the excess of the regular tax rate over the incentive tax rate with respect to such fuel.

(2) DEFINITIONS.—For purposes of paragraph (1)—

(A) REGULAR TAX RATE.—The term "regular tax rate" means—

(i) in the case of gasoline, *diesel fuel, or kerosene* the aggregate rate of tax imposed by section 4081 determined without regard to subsection (c) thereof, and

(ii) in the case of aviation fuel, the aggregate rate of tax imposed by section 4091 determined without regard to subsection (c) thereof.

(B) INCENTIVE TAX RATE.—The term "incentive tax rate" means—

(i) in the case of gasoline, *diesel fuel, or kerosene* the aggregate rate of tax imposed by section 4081 with respect to fuel described in subsection (c)(2) thereof, and

(ii) in the case of aviation fuel, the aggregate rate of tax imposed by section 4091 with respect to fuel described in subsection (c)(2) thereof.

(3) COORDINATION WITH OTHER REPAYMENT PROVISIONS.—No amount shall be payable under paragraph (1) with respect to any gasoline, diesel fuel, *kerosene*, or aviation fuel with respect to which an amount is payable under subsection (d), (e), or (1) of this section or under section 6420 or 6421.

* * *

Amendment Notes

Act Sec. 1032(e)(7) amended Code Sec. 6427(f)(1) and (3) and the heading to (f) by inserting "kerosene," after "diesel fuel,".

Act Sec. 1032(e)(8) amended Code Sec. 6427(f)(2) by striking "or diesel fuel" each place it appears and inserting ", diesel fuel, or kerosene".

The above amendments are effective on July 1, 1998.

Act Sec. 1601(g)(1) provides:

(1) EXTENSION OF PERIOD FOR CLAIMING REFUNDS FOR ALCOHOL FUELS.—Notwithstanding section 6427(i)(3)(C) of the Internal Revenue Code of 1986, a claim filed under section 6427(f) of such Code for any period after September 30, 1995, and before October 1, 1996, shall be treated as timely filed if filed before the 60th day after the date of the enactment of this Act.

(i) TIME FOR FILING CLAIMS; PERIOD COVERED.—

* * *

(3) SPECIAL RULE FOR ALCOHOL MIXTURE CREDIT.—

[*Caution: Code Sec. 6427(i)(3)(A), below, as amended by Act Sec. 1032(e)(9) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

(A) IN GENERAL.—A claim may be filed under subsection (f) by any person with respect to gasoline, *diesel fuel, or kerosene* used to produce a qualified alcohol mixture (as defined in section 4081(c)(3)) for any period—

(i) for which $200 or more is payable under such subsection (f), and

(ii) which is not less than 1 week.

* * *

[*Caution: The heading for Code Sec. 6427(i)(4), below, as amended by Act Sec. 1032(e)(10) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

(4) SPECIAL RULE FOR REFUNDS UNDER SUBSECTION (l).—

* * *

(5) SPECIAL RULE FOR VENDOR REFUNDS.—

(A) IN GENERAL.—A claim may be filed under subsection (l)(5) by any person with respect to fuel sold by such person for any period—

[*Caution: Code Sec. 6427(i)(5)(A)(i), below, as amended by Act Sec. 1032(c)(3)(E) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

(i) for which $200 or more *($100 or more in the case of kerosene)* is payable under subsection (l)(5), and

(ii) which is not less than 1 week.

Notwithstanding subsection (l)(1), paragraph (3)(B) shall apply to claims filed under the preceding sentence.

* * *

Amendment Notes

Act Sec. 1032(c)(3)(E) amended Code Sec. 6427(i)(5)(A)(i) by inserting "($100 or more in the case of kerosene)" after "$200 or more".

Act Sec. 1032(e)(9) amended Code Sec. 6427(i)(3)(A) by striking "or diesel fuel" and inserting ", diesel fuel, or kerosene".

Act Sec. 1032(e)(10) amended the heading of Code Sec. 6427(i)(4) to read as above. Prior to amendment, the heading of Code Sec. 6427(i)(4) read as follows:

(4) SPECIAL RULE FOR NONTAXABLE USES OF DIESEL FUEL AND AVIATION FUEL TAXED UNDER SECTION 4081 OR 4091.—

The above amendments are effective on July 1, 1998.

[*Caution: Code Sec. 6427(l), below, as amended by Act Sec. 1032(c)(3)(A)-(D) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

(l) NONTAXABLE USES OF DIESEL FUEL, *KEROSENE* AND AVIATION FUEL.—

(1) IN GENERAL.—Except as otherwise provided in this subsection and in subsection (k), if—

(A) any diesel fuel *or kerosene* on which tax has been imposed by section 4041 or 4081, or

(B) any aviation fuel on which tax has been imposed by section 4091,

is used by any person in a nontaxable use, the Secretary shall pay (without interest) to the ultimate purchaser of such fuel an amount equal to the aggregate amount of tax imposed on such fuel under section 4041, 4081, or 4091, as the case may be.

(2) NONTAXABLE USE.—For purposes of this subsection, the term "nontaxable use" means—

(A) in the case of diesel fuel *or kerosene*, any use which is exempt from the tax imposed by section 4041(a)(1) other than by reason of a prior imposition of tax, and

(B) in the case of aviation fuel, any use which is exempt from the tax imposed by section 4041(c)(1) other than by reason of a prior imposition of tax.

* * *

(5) REGISTERED VENDORS TO ADMINISTER CLAIMS FOR REFUND OF DIESEL FUEL *OR KEROSENE* SOLD TO FARMERS AND STATE AND LOCAL GOVERNMENTS.—

(A) IN GENERAL.—Paragraph (1) shall not apply to diesel fuel *or kerosene* used—

(i) on a farm for farming purposes (within the meaning of section 6420(c)), or

(ii) by a State or local government.

(B) SALES OF KEROSENE NOT FOR USE IN MOTOR FUEL.—Paragraph (1)(A) shall not apply to kerosene sold by a vendor—

(i) for any use if such sale is from a pump which (as determined under regulations prescribed by the Secretary) is not suitable for use in fueling any diesel-powered highway vehicle or train, or

(ii) to the extent provided by the Secretary, for blending with heating oil to be used during periods of extreme or unseasonable cold.

(C) PAYMENT TO ULTIMATE, REGISTERED VENDOR.—The amount which would (but for *subparagraph (A) or (B)*) have been paid under paragraph (1) with respect to any fuel shall be paid to the ultimate vendor of such fuel, if such vendor—

(i) is registered under section 4101, and

(ii) meets the requirements of subparagraph (A), (B), or (D) of section 6416(a)(1).

* * *

[CCH Explanation at ¶ 1211. Committee Reports at ¶ 11,285.]

Amendment Notes

Act Sec. 1032(c)(3)(A) amended Code Sec. 6427(l) by inserting "or kerosene" after "diesel fuel" each place it appears in paragraphs (1), (2), and (5) (including the heading for paragraph (5)).

Act Sec. 1032(c)(3)(B) amended Code Sec. 6427(l)(5) by redesignating subparagraph (B) as subparagraph (C) and by inserting after subparagraph (A) a new subparagraph (B) to read as above.

Act Sec. 1032(c)(3)(C) amended Code Sec. 6427(l)(5)(C), as redesignated by subparagraph (B) of Act Sec. 1032(c)(3), by striking "subparagraph (A)" and inserting "subparagraph (A) or (B)".

Act Sec. 1032(c)(3)(D) amended Code Sec. 6427(l) by inserting ", KEROSENE" after "DIESEL FUEL" in the heading.

The above amendments are effective on July 1, 1998.

[¶ 5675] CODE SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

(a) GENERAL RULE.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period. *For purposes of this chapter, the term "return" means the return required to be filed by the taxpayer (and does not include a return of any person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit).*

* * *

Amendment Notes

Act Sec. 1284(a) amended Code Sec. 6501(a) by adding at the end a new sentence to read as above.

The above amendment applies to tax years beginning after the date of the enactment of this Act.

(c) EXCEPTIONS.—

* * *

(8) FAILURE TO NOTIFY SECRETARY OF CERTAIN FOREIGN TRANSFERS.—In the case of any information which is required to be reported to the Secretary under section 6038, 6038A, 6038B, 6046, 6046A, or 6048, the time for assessment of any tax imposed by this title with respect to any event or period to which such information relates shall not expire before the date which is 3 years after the date on which the Secretary is furnished the information required to be reported under such section.

(9) GIFT TAX ON CERTAIN GIFTS NOT SHOWN ON RETURN.—If any gift of property the value of which (or any increase in taxable gifts required under section 2701(d) which) is required to be shown on a return of tax imposed by chapter 12 (without regard to section 2503(b)), and is not shown on such return, any tax imposed by chapter 12 on such gift may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time. The preceding sentence shall not apply to any item which is disclosed in such return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item. The value of any item which is so disclosed may not be redetermined by the Secretary after the expiration of the period under subsection (a).

* * *

Amendment Notes

Act Sec. 506(b) amended Code Sec. 6501(c)(9) to read as above. Prior to amendment, Code Sec. 6501(c)(9) read as follows:

(9) GIFT TAX ON CERTAIN GIFTS NOT SHOWN ON RETURN.—If any gift of property the value of which is determined under section 2701 or 2702 (or any increase in taxable gifts required under section 2701(d)) is required to be shown on a return of tax imposed by chapter 12 (without regard to section 2503(b)), and is not shown on such return, any tax imposed by chapter 12 on such gift may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time. The preceding sentence shall not apply to any item not shown as a gift on such return if such item is disclosed in such return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item.

The above amendment applies to gifts made in calendar years ending after the date of the enactment of this Act.

Act Sec. 1145(a) amended Code Sec. 6501(c)(8) to read as above. Prior to amendment, Code Sec. 6501(c)(8) read as follows:

(8) FAILURE TO NOTIFY SECRETARY UNDER SECTION 6038B.—In the case of any tax imposed on any exchange or distribution by reason of subsection (a), (d), or (e) of section 367, the

time for assessment of such tax shall not expire before the date which is 3 years after the date on which the Secretary is notified of such exchange or distribution under section 6038B(a).

The above amendment applies to information the due date for the reporting of which is after the date of the enactment of this Act.

(n) CROSS REFERENCES.—

* * *

(3) For declaratory judgment relating to treatment of items other than partnership items with respect to an oversheltered return, see section 6234.

* * *

[CCH Explanation at ¶ 255, 455, 971 and 1013. Committee Reports at ¶ 10,395, 11,775, 12,370 and 12,550.]

Amendment Notes

Act Sec. 1239(e)(2) amended Code Sec. 6501(o)[(n)] by adding at the end a new paragraph (3) to read as above.

The above amendment applies to partnership tax years ending after the date of the enactment of this Act.

[¶ 5677] CODE SEC. 6503. SUSPENSION OF RUNNING OF PERIOD OF LIMITATION.

(a) ISSUANCE OF STATUTORY NOTICE OF DEFICIENCY.—

(1) GENERAL RULE.—The running of the period of limitations provided in section 6501 or 6502 (or section 6229, but only with respect to a deficiency described in *paragraph (2)(A) or (3) of section 6230(a)*) on the making of assessments or the collection by levy or a proceeding in court, in respect of any deficiency as defined in section 6211 (relating to income, estate, gift and certain excise taxes), shall (after the mailing of a notice under section 6212(a)) be suspended for the period during which the Secretary is prohibited from making the assessment or from collecting by levy or a proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for 60 days thereafter.

* * *

[CCH Explanation at ¶ 451. Committee Reports at ¶ 12,360.]

Amendment Notes

Act Sec. 1237(c)(2) amended Code Sec. 6503(a)(1) by striking "section 6230(a)(2)(A)" and inserting "paragraph (2)(A) or (3) of section 6230(a)".

The above amendment is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) [generally effective for partnership tax years beginning after September 3, 1982.—CCH.].

[¶ 5679] CODE SEC. 6504. CROSS REFERENCES.

For limitation period in case of—

* * *

(4) Application by fiduciary for discharge from personal liability for estate tax, see section 2204.

(5) Insolvent banks and trust companies, see section 7507.

(6) Service in a combat zone, etc., see section 7508.

(7) Claims against transferees and fiduciaries, see chapter 71.

(8) Assessments to recover excessive amounts paid under section 6420 (relating to gasoline used on farms), 6421 (relating to gasoline used for certain nonhighway purposes or by local transit systems), or 6427 (relating to fuels not used for taxable purposes) and assessments of civil penalties under section 6675 for excessive claims under section 6420, 6421, or 6427, see section 6206.

(9) Assessment and collection of interest, see section 6601(g).

(10) Assessment of civil penalties under section 6694 or 6695, see section 6696(d)(1).

(11) Assessments of tax attributable to partnership items, see section 6229.

* * *

[CCH Explanation at ¶ 129. Committee Reports at ¶ 10,315.]

Amendment Notes

Act Sec. 312(d)(13) amended Code Sec. 6504 by striking paragraph (4) and by redesignating the succeeding paragraphs accordingly. Prior to being stricken, Code Sec. 6504(4) read as follows:

(4) Gain upon sale or exchange of principal residence, see section 1034(j).

The above amendment applies to sales and exchanges after May 6, 1997.

[¶ 5681] CODE SEC. 6511. LIMITATIONS ON CREDIT OR REFUND.

* * *

(d) SPECIAL RULES APPLICABLE TO INCOME TAXES.—

* * *

(3) SPECIAL RULES RELATING TO FOREIGN TAX CREDIT.—

(A) SPECIAL PERIOD OF LIMITATION WITH RESPECT TO FOREIGN TAXES PAID OR ACCRUED.—If the claim for credit or refund relates to an overpayment attributable to any taxes paid or accrued to any foreign country or to any possession of the United States for which credit is allowed against the tax imposed by subtitle A in accordance with the provisions of section 901 or the provisions of any treaty to which the United States is a party, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be 10 years from the date prescribed by law for filing the return *for the year in which such taxes were actually paid or accrued.*

* * *

(7) SPECIAL PERIOD OF LIMITATION WITH RESPECT TO SELF-EMPLOYMENT TAX IN CERTAIN CASES.—If—

(A) the claim for credit or refund relates to an overpayment of the tax imposed by chapter 2 (relating to the tax on self-employment income) attributable to Tax Court determination in a proceeding under section 7436, and

(B) the allowance of a credit or refund of such overpayment is otherwise prevented by the operation of any law or rule of law other than section 7122 (relating to compromises),

such credit or refund may be allowed or made if claim therefor is filed on or before the last day of the second year after the calendar year in which such determination becomes final.

* * *

[CCH Explanation at ¶ 922 and 1031. Committee Reports at ¶ 11,390 and 12,985.]

Amendment Notes

Act Sec. 1056(a) amended Code Sec. 6511(d)(3)(A) by striking "for the year with respect to which the claim is made" and inserting "for the year in which such taxes were actually paid or accrued".

The above amendment applies to taxes paid or accrued in tax years beginning after the date of the enactment of this Act.

Act Sec. 1454(b)(1) amended Code Sec. 6511(d) by adding at the end a new paragraph (7) to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5683] CODE SEC. 6512. LIMITATIONS IN CASE OF PETITION TO TAX COURT.

* * *

(b) OVERPAYMENT DETERMINED BY TAX COURT.—

* * *

(2) JURISDICTION TO ENFORCE.—If, after 120 days after a decision of the Tax Court has become final, the Secretary has failed to refund the overpayment determined by the Tax Court, together with the interest thereon as provided in subchapter B of chapter 67, then the Tax Court, upon motion by the taxpayer, shall have jurisdiction to order the refund of such overpayment and interest. *An order of the Tax Court disposing of a motion under this paragraph shall be reviewable in the same manner as a decision of the Tax Court, but only with respect to the matters determined in such order.*

(3) LIMIT ON AMOUNT OF CREDIT OR REFUND.—No such credit or refund shall be allowed or made of any portion of the tax unless the Tax Court determines as part of its decision that such portion was paid—

(A) after the mailing of the notice of deficiency,

(B) within the period which would be applicable under section 6511(b)(2), (c), or (d), if on the date of the mailing of the notice of deficiency a claim had been filed (whether or not filed) stating the grounds upon which the Tax Court finds that there is an overpayment, or

(C) within the period which would be applicable under section 6511(b)(2), (c), or (d), in respect of any claim for refund filed within the applicable period specified in section 6511 and before the date of the mailing of the notice of deficiency—

(i) which had not been disallowed before that date,

(ii) which had been disallowed before that date and in respect of which a timely suit for refund could have been commenced as of that date, or

(iii) in respect of which a suit for refund had been commenced before that date and within the period specified in section 6532.

In the case of a credit or refund relating to an affected item (within the meaning of section 6231(a)(5)), the preceding sentence shall be applied by substituting the periods under sections 6229 and 6230(d) for the periods under section 6511(b)(2), (c), and (d).

In a case described in subparagraph (B) where the date of the mailing of the notice of deficiency is during the third year after the due date (with extensions) for filing the return of tax and no return was filed before such date, the applicable period under subsections (a) and (b)(2) of section 6511 shall be 3 years.

(4) DENIAL OF JURISDICTION REGARDING CERTAIN CREDITS AND REDUCTIONS.—The Tax Court shall have no jurisdiction under this subsection to restrain or review any credit or reduction made by the Secretary under section 6402.

* * *

[CCH Explanation at ¶ 455, 1010 and 1025. Committee Reports at ¶ 12,370, 12,540 and 12,955.]

Amendment Notes

Act Sec. 1239(c)(2) amended Code Sec. 6512(b)(3) by adding at the end a new sentence to read as above.

The above amendment applies to partnership tax years ending after the date of the enactment of this Act.

Act Sec. 1282(a) amended Code Sec. 6512(b)(3) by adding at the end a new flush sentence to read as above.

The above amendment applies to claims for credit or refund for tax years ending after the date of the enactment of this Act.

Act Sec. 1451(a) amended Code Sec. 6512(b)(2) by adding at the end a new sentence to read as above.

Act Sec. 1451(b) amended Code Sec. 6512(b) by adding at the end a new paragraph (4) to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5685] CODE SEC. 6601. INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

* * *

(c) SUSPENSION OF INTEREST IN CERTAIN INCOME, ESTATE, GIFT, AND CERTAIN EXCISE TAX CASES.—In the case of a deficiency as defined in section 6211 (relating to income, estate, gift, and certain excise taxes), if a waiver of restrictions under section 6213(d) on the assessment of such deficiency has been filed, and if notice and demand by the Secretary for payment of such deficiency is not made within 30 days after the filing of such waiver, interest shall not be imposed on such deficiency for the period beginning immediately after such 30th day and ending with the date of notice and demand and interest shall not be imposed during such period on any interest with respect to such deficiency for any prior period. *In the case of a settlement under section 6224(c) which results in the conversion of partnership items to nonpartnership items pursuant to section 6231(b)(1)(C), the preceding sentence shall apply to a computational adjustment resulting from such settlement in the same manner as if such adjustment were a deficiency and such settlement were a waiver referred to in the preceding sentence.*

Amendment Notes

Act Sec. 1242(a) amended Code Sec. 6601(c) by adding at the end a new sentence to read as above.

The above amendment applies to adjustments with respect to partnership tax years beginning after the date of the enactment of this Act.

(d) INCOME TAX REDUCED BY CARRYBACK OR ADJUSTMENT FOR CERTAIN UNUSED DEDUCTIONS.—

* * *

(2) FOREIGN TAX CREDIT CARRYBACKS.—If any credit allowed for any taxable year is increased by reason of a carryback of tax paid or accrued to foreign countries or possessions of the United States, such increase shall not affect the computation of interest under this section for the period ending with the filing date for the taxable year in which such taxes were in fact paid or accrued, or, with respect to any portion of such credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such increase shall not affect the computation of interest under this section for the period ending with the filing date for such subsequent taxable year.

(3) CERTAIN CREDIT CARRYBACKS.—

* * *

(4) FILING DATE.—For purposes of this subsection, the term "filing date" has the meaning given to such term by section 6611(f)(3)(A).

* * *

Amendment Notes

Act Sec. 1055(a) amended Code Sec. 6601(d) by redesignating paragraphs (2) and (3) as paragraphs (3) and (4),

respectively, and by inserting after paragraph (1) a new paragraph (2) to read as above.

The above amendment applies to foreign tax credit carrybacks arising in tax years beginning after the date of the enactment of this Act.

(j) *2-Percent* Rate on Certain Portion of Estate Tax Extended Under Section 6166.—

(1) In general.—If the time for payment of an amount of tax imposed by chapter 11 is extended as provided in section 6166, then in lieu of the annual rate provided by subsection (a)—

(A) interest on the 2-percent portion of such amount shall be paid at the rate of 2 percent, and

(B) interest on so much of such amount as exceeds the 2-percent portion shall be paid at a rate equal to 45 percent of the annual rate provided by subsection (a).

For purposes of this subsection, the amount of any deficiency which is prorated to installments payable under section 6166 shall be treated as an amount of tax payable in installments under such section.

(2) 2-percent portion.—For purposes of this subsection, the term "2-percent portion" means the lesser of—

(A)(i) the amount of the tentative tax which would be determined under the rate schedule set forth in section 2001(c) if the amount with respect to which such tentative tax is to be computed were the sum of $1,000,000 and the applicable exclusion amount in effect under section 2010(c), reduced by

(ii) the applicable credit amount in effect under section 2010(c), or

(B) the amount of the tax imposed by chapter 11 which is extended as provided in section 6166.

(3) Inflation adjustment.—In the case of estates of decedents dying in a calendar year after 1998, the $1,000,000 amount contained in paragraph (2)(A) shall be increased by an amount equal to—

(A) $1,000,000, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 1997" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the next lowest multiple of $10,000.

(4) Treatment of payments.—If the amount of tax imposed by chapter 11 which is extended as provided in section 6166 exceeds the *2-percent* portion, any payment of a portion of such amount shall, for purposes of computing interest for periods after such payment, be treated as reducing the *2-percent* portion by an amount which bears the same ratio to the amount of such payment as the amount of the *2-percent* portion (determined without regard to this paragraph) bears to the amount of the tax which is extended as provided in section 6166.

* * *

[CCH Explanation at ¶ 204, 227, 461 and 924. Committee Reports at ¶ 10,370, 10,380, 11,385 and 12,385.]

Amendment Notes

Act Sec. 501(e) amended Code Sec. 6601(j) by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) a new paragraph (3) to read as above.

The above amendment applies to the estates of decedents dying, and gifts made, after December 31, 1997.

Act Sec. 503(a) amended Code Sec. 6601(j)(1)-(2) to read as above. Prior to amendment, Code Sec. 6601(j)(1)-(2) read as follows:

(1) In general.—If the time for payment of an amount of tax imposed by chapter 11 is extended as provided in section 6166, interest on the 4-percent portion of such amount shall (in lieu of the annual rate provided by subsection (a)) be paid at the rate of 4 percent. For purposes of this subsection, the amount of any deficiency which is prorated to installments payable under section 6166 shall be treated as an amount of tax payable in installments under such section.

(2) 4-percent portion.—For purposes of this subsection, the term "4-percent portion" means the lesser of—

(A) $345,800 reduced by the amount of the credit allowable under section 2010(a); or

(B) the amount of the tax imposed by chapter 11 which is extended as provided in section 6166.

Act Sec. 503(c)(2) amended Code Sec. 6601(j)(4), as redesignated by Act Sec. 501(e), by striking "4-percent" each place it appears and inserting "2-percent".

Act Sec. 503(c)(3) amended Code Sec. 6601(j) by striking "4-Percent" in the subsection heading and inserting "2-Percent".

The above amendments generally apply to estates of decedents dying after December 31, 1997. For a special rule, see Act Sec. 503(d)(2), below.

Act Sec. 503(d)(2) provides:

(2) Election.—In the case of the estate of any decedent dying before January 1, 1998, with respect to which there is an election under section 6166 of the Internal Revenue Code of 1986, the executor of the estate may elect to have the amendments made by this section apply with respect to

installments due after the effective date of the election; except that the 2-percent portion of such installments shall be equal to the amount which would be the 4-percent portion of such installments without regard to such election. Such an election shall be made before January 1, 1999 in the manner prescribed by the Secretary of the Treasury and, once made, is irrevocable.

[¶ 5687] CODE SEC. 6611. INTEREST ON OVERPAYMENTS.

* * *

(f) REFUND OF INCOME TAX CAUSED BY CARRYBACK OR ADJUSTMENT FOR CERTAIN UNUSED DEDUCTIONS.—

* * *

(2) FOREIGN TAX CREDIT CARRYBACKS.—For purposes of subsection (a), if any overpayment of tax imposed by subtitle A results from a carryback of tax paid or accrued to foreign countries or possessions of the United States, such overpayment shall be deemed not to have been made before the filing date for the taxable year in which such taxes were in fact paid or accrued, or, with respect to any portion of such credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such overpayment shall be deemed not to have been made before the filing date for such subsequent taxable year.

(3) CERTAIN CREDIT CARRYBACKS.—

* * *

(4) SPECIAL RULES FOR *PARAGRAPHS (1), (2), AND (3).*—

* * *

(B) COORDINATION WITH SUBSECTION (e).—

(i) IN GENERAL.—For purposes of subsection (e)—

(I) any overpayment described in *paragraph (1), (2), or (3)* shall be treated as an overpayment for the loss year, and

(II) such subsection shall be applied with respect to such overpayment by treating the return for the loss year as not filed before claim for such overpayment is filed.

(ii) LOSS YEAR.—For purposes of this subparagraph, the term "loss year" means—

(I) in the case of a carryback of a net operating loss or net capital loss, the taxable year in which such loss arises,

(II) in the case of a carryback of taxes paid or accrued to foreign countries or possessions of the United States, the taxable year in which such taxes were in fact paid or accrued (or, with respect to any portion of such carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such subsequent taxable year), and

(III) in the case of a credit carryback *(as defined in paragraph (3)(B)),* the taxable year in which such credit carryback arises (or, with respect to any portion of a credit carryback from a taxable year attributable to a net operating loss carryback, a capital loss carryback, or other credit carryback from a subsequent taxable year, such subsequent taxable year).

(C) APPLICATION OF SUBPARAGRAPH (B) WHERE SECTION 6411(A) CLAIM FILED.—For purposes of subparagraph (B)(i)(II), if a taxpayer—

(i) files a claim for refund of any overpayment described in *paragraph (1), (2), or (3)* with respect to the taxable year to which a loss or credit is carried back, and

(ii) subsequently files an application under section 6411(a) with respect to such overpayment,

then the claim for overpayment shall be treated as having been filed on the date the application under section 6411(a) was filed.

* * *

Amendment Notes

Act Sec. 1055(b)(1) amended Code Sec. 6611(f) by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively, and by inserting after paragraph (1) a new paragraph (2) to read as above.

Act Sec. 1055(b)(2)(A)(i)-(ii) amended Code Sec. 6611(f)(4), as so redesignated, by striking "PARAGRAPHS (1) AND (2)" [in the heading] and inserting "PARAGRAPHS (1), (2), AND (3)", and by striking "paragraph (1) or (2)" each place it appears and inserting "paragraph (1), (2), or (3)".

Act Sec. 1055(b)(2)(B) amended Code Sec. 6611(f)(4)(B)(ii), as so redesignated, by striking "and" at the end of subclause (I), by redesignating subclause (II) as subclause (III), and by inserting after subclause (I) a new subclause (II) to read as above.

Act Sec. 1055(b)(2)(C) amended Code Sec. 6611(f)(4)(B)(ii)(III), as so redesignated, by inserting "(as defined in paragraph (3)(B))" after "credit carryback" the first place it appears.

The above amendments apply to foreign tax credit carrybacks arising in tax years beginning after the date of the enactment of this Act.

(g) No Interest Until Return in Processible Form.—

* * *

Amendment Notes

Act Sec. 1055(b)(2)(D) amended Code Sec. 6611 by striking subsection (g) and by redesignating subsections (h) and (i) as subsections (g) and (h), respectively. Prior to being stricken, Code Sec. 6611(g) read as follows:

(g) Refund of Income Tax Caused by Carryback of Foreign Taxes.—For purposes of subsection (a), if any overpayment of tax results from a carryback of tax paid or accrued to foreign countries or possessions of the United States, such overpayment shall be deemed not to have been paid or accrued prior to the filing date (as defined in subsection (f)(3)) for the taxable year under this subtitle in which such taxes were in fact paid or accrued.

The above amendment applies to foreign tax credit carrybacks arising in tax years beginning after the date of the enactment of this Act.

(h) Prohibition of Administrative Review.—

* * *

[CCH Explanation at ¶ 924. Committee Reports at ¶ 11,385.]

Amendment Notes

Act Sec. 1055(b)(2)(D) amended Code Sec. 6611 by redesignating subsection (i) as subsection (h).

The above amendment applies to foreign tax credit carrybacks arising in tax years beginning after the date of the enactment of this Act.

[¶ 5689] CODE SEC. 6621. DETERMINATION OF RATE OF INTEREST.

(a) General Rule.—

(1) Overpayment rate.—The overpayment rate established under this section shall be the sum of—

(A) the Federal short-term rate determined under subsection (b), plus

(B) 2 percentage points.

To the extent that an overpayment of tax by a corporation for any taxable period (as defined in *subsection (c)(3), applied by substituting "overpayment" for "underpayment")* exceeds $10,000, subparagraph (B) shall be applied by substituting "0.5 percentage point" for "2 percentage points".

* * *

Amendment Notes

Act Sec. 1604(b)(1) amended Code Sec. 6621(a)(1) by striking "subsection (c)(3))" in the last sentence and inserting "subsection (c)(3), applied by substituting 'overpayment' for 'underpayment')".

The above amendment is effective as if included in the section of the Uruguay Round Agreements Act (P.L. 103-465) to which it relates [effective for determining interest for periods after December 31, 1994.—CCH.].

(c) Increase in Underpayment Rate for Large Corporate Underpayments.—

* * *

(2) Applicable rate.—For purposes of this subsection—

* * *

(B) Special rules.—

* * *

(iii) Exception for letters or notices involving small amounts.—For purposes of this paragraph, any letter or notice shall be disregarded if the amount of the deficiency or proposed deficiency (or the assessment or proposed assessment) set forth in such letter or notice is not greater than $100,000 (determined by not taking into account any interest, penalties, or additions to tax).

* * *

[CCH Explanation at ¶ 1108. Committee Reports at ¶ 13,125.]

Amendment Notes

Act Sec. 1463(a) amended Code Sec. 6621(c)(2)(B) by adding at the end a new clause (iii) to read as above.

The above amendment applies for purposes of determining interest for periods after December 31, 1997.

[¶ 5691] CODE SEC. 6652. FAILURE TO FILE CERTAIN INFORMATION RETURNS, REGISTRATION STATEMENTS, ETC.

* * *

(e) INFORMATION REQUIRED IN CONNECTION WITH CERTAIN PLANS OF DEFERRED COMPENSATION; ETC.—In the case of failure to file a return or statement required under section 6058 (relating to information required in connection with certain plans of deferred compensation), 6047 (relating to information relating to certain trusts and annuity and bond purchase plans), or 6039D (relating to returns and records with respect to certain fringe benefit plans) on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing so to file, $25 for each day during which such failure continues, but the total amount imposed under this subsection on any person for failure to file any return shall not exceed $15,000. This subsection shall not apply to any return or statement which is an information return described in section 6724(d)(1)(C)(ii) or a payee statement described in *section 6724(d)(2)(Y)*.

* * *

Amendment Notes

Act Sec. 1602(d)(2)(B) amended Code Sec. 6652(e) by striking "section 6724(d)(2)(X)" in the last sentence and inserting "section 6724(d)(2)(Y)".

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which it relates [effective for benefits paid after December 31, 1996.—CCH.].

(g) INFORMATION REQUIRED IN CONNECTION WITH DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—In the case of failure to make a report required by section 219(f)(4) which contains the information required by such section on the date prescribed therefor (determined with regard to any extension of time for filing), there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing so to file, an amount equal to $25 for each participant with respect to whom there was a failure to file such information, multiplied by the number of years during which such failure continues, but the total amount imposed under this subsection on any person for failure to file shall not exceed $10,000. *No penalty shall be imposed under this subsection on any failure which is shown to be due to reasonable cause and not willful neglect.*

* * *

Amendment Notes

Act Sec. 1281(a) amended Code Sec. 6652(g) by adding at the end a new sentence to read as above.

The above amendment applies to tax years beginning after the date of the enactment of this Act.

(k) FAILURE TO MAKE REPORTS REQUIRED UNDER SECTION 1202.—In the case of a failure to make a report required under section 1202(d)(1)(C) which contains the information required by such section on the date prescribed therefor (determined with regard to any extension of time for filing), there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing to make such report, an amount equal to $50 for each report with respect to which there was such a failure. In the case of any failure due to negligence or intentional disregard, the preceding sentence shall be applied by substituting "$100" for "$50". In the case of a report covering periods in 2 or more years, the penalty determined under preceding provisions of this subsection shall be multiplied by the number of such years. *No penalty shall be imposed under this subsection on any failure which is shown to be due to reasonable cause and not willful neglect.*

* * *

[CCH Explanation at ¶ 839 and 1001. Committee Reports at ¶ 12,535 and 13,825.]

Amendment Notes

Act Sec. 1281(b) amended Code Sec. 6652(k) by adding at the end a new sentence to read as above.

The above amendment applies to tax years beginning after the date of the enactment of this Act.

[¶ 5693] CODE SEC. 6654. FAILURE BY INDIVIDUAL TO PAY ESTIMATED INCOME TAX.

* * *

(d) AMOUNT OF REQUIRED INSTALLMENTS.—For purposes of this section—

(1) AMOUNT.—

* * *

(C) LIMITATION ON USE OF PRECEDING YEAR'S TAX.—

(i) IN GENERAL.—If the adjusted gross income shown on the return of the individual for the preceding taxable year beginning in any calendar year exceeds $150,000, clause (ii) of subparagraph (B) shall be applied by substituting the applicable percentage for "100

percent". For purposes of the preceding sentence, the applicable percentage shall be determined in accordance with the following table:

If the preceding taxable year begins in:	*The applicable percentage is:*
1998, 1999, or 2000	*105*
2001	*112*
2002 or thereafter	*110*

This clause shall not apply in the case of a preceding taxable year beginning in calendar year 1997.

* * *

Amendment Notes

Act Sec. 1091(a) amended Code Sec. 6654(d)(1)(C)(i) to read as above. Prior to amendment, Code Sec. 6654(d)(1)(C)(i) read as follows:

(i) IN GENERAL.—If the adjusted gross income shown on the return of the individual for the preceding taxable year exceeds $150,000, clause (ii) of subparagraph (B) shall be applied by substituting "110 percent" for "100 percent".

The above amendment applies with respect to any installment payment for tax years beginning after December 31, 1997.

(e) EXCEPTIONS.—

(1) WHERE TAX IS SMALL AMOUNT.—No addition to tax shall be imposed under subsection (a) for any taxable year if the tax shown on the return for such taxable year (or, if no return is filed, the tax), reduced by the credit allowable under section 31, is less than *$1,000.*

* * *

[CCH Explanation at ¶ 1101 and 1103. Committee Reports at ¶ 11,565 and 12,125.]

Amendment Notes

Act Sec. 1202(a) amended Code Sec. 6654(e)(1) by striking "$500" and inserting "$1,000".

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5695] CODE SEC. 6655. FAILURE BY CORPORATION TO PAY ESTIMATED INCOME TAX.

* * *

(g) DEFINITIONS AND SPECIAL RULES.—

* * *

(3) CERTAIN TAX-EXEMPT ORGANIZATIONS.—For purposes of this section—

(A) Any organization subject to the tax imposed by section 511, and any private foundation, shall be treated as a corporation subject to tax under section 11.

(B) Any tax imposed by section 511, and any tax imposed by section 1 or 4940 on a private foundation, shall be treated as a tax imposed by section 11.

(C) Any reference to taxable income shall be treated as including a reference to unrelated business taxable income or net investment income (as the case may be).

In the case of any organization described in subparagraph (A), subsection (b)(2)(A) shall be applied by substituting "5th month" for "3rd month", subsection (e)(2)(A) shall be applied by substituting "2 months" for "3 months" in clause (i)(I), the election under clause (i) of subsection (e)(2)(C) may be made separately for each installment, and clause (ii) of subsection (e)(2)(C) shall not apply. *In the case of a private foundation, subsection (c)(2) shall be applied by substituting "May 15" for "April 15".*

* * *

[CCH Explanation at ¶ 623. Committee Reports at ¶ 13,115.]

Amendment Notes

Act Sec. 1461(a) amended Code Sec. 6655(g)(3) by adding at the end a new sentence to read as above.

The above amendment applies for purposes of determining underpayments of estimated tax for tax years beginning after the date of the enactment of this Act.

[¶ 5697] CODE SEC. 6662. IMPOSITION OF ACCURACY-RELATED PENALTY.

* * *

(d) SUBSTANTIAL UNDERSTATEMENT OF INCOME TAX.—

* * *

(2) UNDERSTATEMENT.—

* * *

(B) REDUCTION FOR UNDERSTATEMENT DUE TO POSITION OF TAXPAYER OR DISCLOSED ITEM.—The amount of the understatement under subparagraph (A) shall be reduced by that portion of the understatement which is attributable to—

(i) the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment, or

(ii) any item if—

(I) the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return, and

(II) there is a reasonable basis for the tax treatment of such item by the taxpayer.

For purposes of clause (ii)(II), in no event shall a corporation be treated as having a reasonable basis for its tax treatment of an item attributable to a multiple-party financing transaction if such treatment does not clearly reflect the income of the corporation.

(C) SPECIAL RULES IN CASES INVOLVING TAX SHELTERS.—

* * *

(iii) TAX SHELTER.—For purposes of this subparagraph, the term "tax shelter" means—

(I) a partnership or other entity,

(II) any investment plan or arrangement, or

(III) any other plan or arrangement,

if *a significant purpose* of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.

* * *

[CCH Explanation at ¶ 1058. Committee Reports at ¶ 11,250.]

Amendment Notes

Act Sec. 1028(c)(1) amended Code Sec. 6662(d)(2)(B) by adding at the end a new flush sentence to read as above.

Act Sec. 1028(c)(2) amended Code Sec. 6662(d)(2)(C)(iii) by striking "the principal purpose" and inserting "a significant purpose".

The above amendments apply to items with respect to transactions entered into after the date of the enactment of this Act.

[¶ 5699] CODE SEC. 6679. FAILURE TO FILE RETURNS, ETC., WITH RESPECT TO FOREIGN CORPORATIONS OR FOREIGN PARTNERSHIPS.

(a) CIVIL PENALTY.—

(1) IN GENERAL.—In addition to any criminal penalty provided by law, any person required to file a return under section 6035, 6046, or 6046A who fails to file such return at the time provided in such section, or who files a return which does not show the information required pursuant to such section, shall pay a penalty of $10,000, unless it is shown that such failure is due to reasonable cause.

(2) INCREASE IN PENALTY WHERE FAILURE CONTINUES AFTER NOTIFICATION.—If any failure described in paragraph (1) continues for more than 90 days after the day on which the Secretary mails notice of such failure to the United States person, such person shall pay a penalty (in addition to the amount required under paragraph (1)) of $10,000 for each 30-day period (or fraction thereof) during which such failure continues after the expiration of such 90-day period. The increase in any penalty under this paragraph shall not exceed $50,000.

(3) REDUCED PENALTY FOR RETURNS RELATING TO FOREIGN PERSONAL HOLDING COMPANIES.—In the case of a return required under section 6035, paragraph (1) shall be applied by substituting "$1,000" for "$10,000", and paragraph (2) shall not apply.

* * *

[CCH Explanation at ¶ 985 and 986. Committee Reports at ¶ 11,765.]

Amendment Notes

Act Sec. 1143(b) amended Code Sec. 6679(a) to read as above. Prior to amendment, Code Sec. 6679(a) read as follows:

(a) CIVIL PENALTY.—In addition to any criminal penalty provided by law, any person required to file a return under section 6035, 6046, or 6046A who fails to file such return at the time provided in such section, or who files a return which does not show the information required pursuant to such section, shall pay a penalty of $1,000, unless it is shown that such failure is due to reasonable cause.

The above amendment applies to transfers and changes after the date of the enactment of this Act.

[¶ 5701] CODE SEC. 6683. FAILURE OF FOREIGN CORPORATION TO FILE RETURN OF PERSONAL HOLDING COMPANY TAX.

Any foreign corporation which—

(1) is a personal holding company for any taxable year, and

(2) fails to file or to cause to be filed with the Secretary a true and accurate return of the tax imposed by section 541,

shall, in addition to other penalties provided by law, pay a penalty equal to 10 percent of the taxes imposed by chapter 1 (including the tax imposed by section 541) on such foreign corporation for such taxable year. *No penalty shall be imposed under this section on any failure which is shown to be due to reasonable cause and not willful neglect.*

[CCH Explanation at ¶ 1001. Committee Reports at ¶ 12,535.]

Amendment Notes

Act Sec. 1281(c) amended Code Sec. 6683 by adding at the end a new sentence to read as above.

The above amendment applies to tax years beginning after the date of the enactment of this Act.

[¶ 5703] CODE SEC. 6693. FAILURE TO PROVIDE REPORTS ON *CERTAIN TAX-FAVORED* ACCOUNTS OR ANNUITIES; PENALTIES RELATING TO DESIGNATED NONDEDUCTIBLE CONTRIBUTIONS.

(a) REPORTS.—

* * *

(2) PROVISIONS.—The provisions referred to in this paragraph are—

(A) subsections (i) and (l) of section 408 (relating to individual retirement plans),

(B) section 220(h) (relating to medical savings accounts),

(C) Section 529(d) (relating to qualified State tuition programs), and

(D) Section 530(h) (relating to education individual retirement accounts).

This subsection shall not apply to any report which is an information return described in section 6724(d)(1)(C)(i) or a payee statement described in section 6724(d)(2)(X).

* * *

Amendment Notes

Act Sec. 211(e)(2)(B) amended Code Sec. 6693(a)(2) by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and ", and by adding a new subparagraph (C) to read as above.

Act Sec. 211(e)(2)(C) amended Code Sec. 6693 by striking "INDIVIDUAL RETIREMENT" in the section heading and inserting "CERTAIN TAX-FAVORED".

The above amendments are effective on January 1, 1998.

Act Sec. 213(c) amended Code Sec. 6693(a)(2) by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting ", and", and by adding a new subparagraph (D) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

Act Sec. 1602(a)(4) amended Code Sec. 6693(a) by adding at the end a new sentence to read as above.

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

(c) PENALTIES RELATING TO SIMPLE RETIREMENT ACCOUNTS.—

* * *

(2) TRUSTEE *AND ISSUER* PENALTIES.—A trustee *or issuer* who fails—

* * *

[CCH Explanation at ¶ 145, 149, 741 and 811. Committee Reports at ¶ 10,175, 10,185, 13,565 and 13,770.]

Amendment Notes

Act Sec. 1601(d)(1)(C)(ii)(I)-(II) amended Code Sec. 6693(c)(2) by inserting "or issuer" after "trustee", and by inserting "AND ISSUER" after "TRUSTEE" in the heading.

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for tax years beginning after December 31, 1996.—CCH.].

[¶ 5705] CODE SEC. 6695. OTHER ASSESSABLE PENALTIES WITH RESPECT TO THE PREPARATION OF INCOME TAX RETURNS FOR OTHER PERSONS.

* * *

(g) Failure To Be Diligent in Determining Eligibility for Earned Income Credit.—Any person who is an income tax return preparer with respect to any return or claim for refund who fails to comply with due diligence requirements imposed by the Secretary by regulations with respect to determining eligibility for, or the amount of, the credit allowable by section 32 shall pay a penalty of $100 for each such failure.

* * *

[CCH Explanation at ¶ 127. Committee Reports at ¶ 11,536.]

Amendment Notes

Act Sec. 1085(a)(2) amended Code Sec. 6695 by adding at the end a new subsection (g) to read as above.

The above amendment applies to tax years beginning after December 31, 1996.

[¶ 5707] CODE SEC. 6707. FAILURE TO FURNISH INFORMATION REGARDING TAX SHELTERS.

(a) Failure To Register Tax Shelter.—

(1) Imposition of penalty.—If a person who is required to register a tax shelter under section 6111(a)—

(A) fails to register such tax shelter on or before the date described in section 6111(a)(1), or

(B) files false or incomplete information with the Secretary with respect to such registration,

such person shall pay a penalty with respect to such registration in the amount determined under *paragraph (2) or (3), as the case may be.* No penalty shall be imposed under the preceding sentence with respect to any failure which is due to reasonable cause.

(2) Amount of penalty.—*Except as provided in paragraph (3), the penalty* imposed under paragraph (1) with respect to any tax shelter shall be an amount equal to the greater of—

(A) 1 percent of the aggregate amount invested in such tax shelter, or

(B) $500.

(3) Confidential arrangements.—

(A) In general.—In the case of a tax shelter (as defined in section 6111(d)), the penalty imposed under paragraph (1) shall be an amount equal to the greater of—

(i) 50 percent of the fees paid to all promoters of the tax shelter with respect to offerings made before the date such shelter is registered under section 6111, or

(ii) $10,000.

Clause (i) shall be applied by substituting "75 percent" for "50 percent" in the case of an intentional failure or act described in paragraph (1).

(B) Special rule for participants required to register shelter.—In the case of a person required to register such a tax shelter by reason of section 6111(d)(3)—

(i) such person shall be required to pay the penalty under paragraph (1) only if such person actually participated in such shelter,

(ii) the amount of such penalty shall be determined by taking into account under subparagraph (A)(i) only the fees paid by such person, and

(iii) such penalty shall be in addition to the penalty imposed on any other person for failing to register such shelter.

* * *

[CCH Explanation at ¶ 1058. Committee Reports at ¶ 11,250.]

Amendment Notes

Act Sec. 1028(b) amended Code Sec. 6707(a) by adding at the end a new paragraph (3) to read as above.

Act Sec. 1028(d)(1) amended Code Sec. 6707(a)(2) by striking "The penalty" and inserting "Except as provided in paragraph (3), the penalty".

Act Sec. 1028(d)(2) amended Code Sec. 6707(a)(1)(A) [6707(a)(1)] by striking "paragraph (2)" and inserting "paragraph (2) or (3), as the case may be".

The above amendments apply to any tax shelter (as defined in Code Sec. 6111(d), as amended) interests in which are offered to potential participants after the Secretary of the Treasury prescribes guidance with respect to meeting requirements added by such amendments.

[¶ 5709] CODE SEC. 6715. DYED FUEL SOLD FOR USE OR USED IN TAXABLE USE, ETC.

* * *

(c) DEFINITIONS.—For purposes of this section—

[Caution: Code Sec. 6715(c)(1), below, as amended by Act Sec. 1032(e)(11) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.]

(1) DYED FUEL.—The term "dyed fuel" means any dyed diesel fuel *or kerosene*, whether or not the fuel was dyed pursuant to section 4082.

* * *

[CCH Explanation at ¶ 1211. Committee Reports at ¶ 11,285.]

Amendment Notes

Act Sec. 1032(e)(11) amended Code Sec. 6715(c)(1) by inserting "or kerosene" after "diesel fuel".

The above amendment is effective on July 1, 1998.

[¶ 5711] CODE SEC. 6724. WAIVER; DEFINITIONS AND SPECIAL RULES.

* * *

(d) DEFINITIONS.—For purposes of this part—

(1) INFORMATION RETURN.—The term "information return" means—

(A) any statement of the amount of payments to another person required by—

(i) section 6041(a) or (b) (relating to certain information at source),

(ii) section 6042(a)(1) (relating to payments of dividends),

(iii) section 6044(a)(1) (relating to payments of patronage dividends),

(iv) section 6049(a) (relating to payments of interest),

(v) section 6050A(a) (relating to reporting requirements of certain fishing boat operators),

(vi) section 6050N(a) (relating to payments of royalties),

(vii) section 6051(d) (relating to information returns with respect to income tax withheld),

(viii) section 6050R (relating to returns relating to certain purchases of fish), *or*

(ix) section 110(d) (relating to qualified lessee construction allowances for short-term leases),

(B) any return required by—

(i) section 6041A(a) or (b) (relating to returns of direct sellers),

(ii) section 6045(a) or (d) (relating to returns of brokers),

(iii) section 6050H(a) (relating to mortgage interest received in trade or business from individuals),

(iv) section 6050I(a) or (g)(1) (relating to cash received in trade or business, etc.),

(v) section 6050J(a) (relating to foreclosures and abandonments of security),

(vi) section 6050K(a) (relating to exchanges of certain partnership interests),

(vii) section 6050L(a) (relating to returns relating to certain dispositions of donated property),

(viii) section 6050P (relating to returns relating to the cancellation of indebtedness by certain financial entities),

(ix) section 6050Q (relating to certain long-term care benefits),

(ix)[(x)] section 6050S (relating to returns relating to payments for qualified tuition and related expenses),

(x)[(xi)] section 6052(a) (relating to reporting payment of wages in the form of group-life insurance),

(xi)[(xii)] section 6053(c)(1) (relating to reporting with respect to certain tips),

(xii)[(xiii)] subsection (b) or (e) of section 1060 (relating to reporting requirements of transferors and transferees in certain asset acquisitions),

(xiii)[(xiv)] subparagraph (A) or (C) of subsection (c)(4) of section 4093 (relating to information reporting with respect to tax on diesel and aviation fuels), or

(xiv)[(xv)] section 4101(d) (relating to information reporting with respect to fuels taxes) [, or]

(xv)[(xvi)] subparagraph (C) of section 338(h)(10) (relating to information required to be furnished to the Secretary in case of elective recognition of gain or loss).

* * *

(2) PAYEE STATEMENT.—The term "payee statement" means any statement required to be furnished under—

* * *

(R) section 6050R(c) (relating to returns relating to certain purchases of fish),

(S) section 6051 (relating to receipts for employees),

(T) section 6052(b) (relating to returns regarding payment of wages in the form of group-term life insurance),

(U) section 6053(b) or (c) (relating to reports of tips),

(V) section 6048(b)(1)(B) (relating to foreign trust reporting requirements),

(W) section 4093(c)(4)(B) (relating to certain purchasers of diesel and aviation fuels),

(X) section 408(i) (relating to reports with respect to individual retirement plans) to any person other than the Secretary with respect to the amount of payments made to such person,

(Y) section 6047(d) (relating to reports by plan administrators) to any person other than the Secretary with respect to the amount of payments made to such person, or

(Z) section 6050S(d) (relating to returns relating to qualified tuition and related expenses).

* * *

Amendment Notes

Act Sec. 201(c)(2)(A) amended Code Sec. 6724(d)(1)(B) by redesignating clauses (ix) through (xiv) as clauses (x) through (xv), respectively, and by inserting after clause (viii) a new clause (ix) to read as above.

Act Sec. 201(c)(2)(B) amended Code Sec. 6724(d)(2) by striking "or" at the end of the next to last subparagraph, by striking the period at the end of the last subparagraph and inserting ", or", and by adding at the end a new subparagraph (Z) to read as above.

The above amendments apply to expenses paid after December 31, 1997 (in tax years ending after such date), for education furnished in academic periods beginning after such date.

Act Sec. 1213(b) amended Code Sec. 6724(d)(1)(A) by striking "or" at the end of clause (vii), by adding "or" at the end of clause (viii), and by adding at the end a new clause (ix) to read as above.

The above amendment applies to leases entered into after the date of the enactment of this Act.

Act Sec. 1602(d)(2)(A) amended Code Sec. 6724(d)(2) by striking so much as follows subparagraph (Q) and precedes the last sentence, and inserting new subparagraphs (R) through (Y) to read as above. Prior to amendment, the material following Code Sec. 6724(d)(2)(Q) and preceding the last sentence read as follows:

(R) section 6051 (relating to receipts for employees),

(S) section 6050R(c) (relating to returns relating to certain purchases of fish),

(T) section 6052(b) (relating to returns regarding payment of wages in the form of group-term life insurance),

(U) section 6053(b) or (c) (relating to reports of tips),

(U)[(V)] section 4093(c)(4)(B) (relating to certain purchasers of diesel and aviation fuels),

(V)[(W)] section 6048(b)(1)(B) (relating to foreign trust reporting requirements),

(W)[(X)] section 408(i) (relating to reports with respect to individual retirement plans) to any person other than the Secretary with respect to the amount of payments made to such person, or

(X)[(Y)] section 6047(d) (relating to reports by plan administrators) to any person other than the Secretary with respect to the amount of payments made to such person.

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which it relates [effective for benefits paid after December 31, 1996.—CCH.].

(e) SPECIAL RULE FOR CERTAIN PARTNERSHIP RETURNS.—If any partnership return under section 6031(a) is required under section 6011(e) to be filed on magnetic media or in other machine-readable form, for purposes of this part, each schedule required to be included with such return with respect to each partner shall be treated as a separate information return.

* * *

[CCH Explanation at ¶ 139, 322, 430 and 839. Committee Reports at ¶ 10,135, 12,175, 12,275 and 13,825.]

Amendment Notes

Act Sec. 1223(b) amended Code Sec. 6724 by adding at the end a new subsection (e) to read as above.

The above amendment applies to partnership tax years ending on or after December 31, 1997.

[¶ 5712] CODE SEC. 7213. UNAUTHORIZED DISCLOSURE OF INFORMATION.

(a) RETURNS AND RETURN INFORMATION.—

* * *

(2) STATE AND OTHER EMPLOYEES.—It shall be unlawful for any person (not described in paragraph (1)) willfully to disclose to any person, except as authorized in this title, any return or return information (as defined in section 6103(b)) acquired by him or another person under subsection (d), (i)(3)(B)(i), (l)(6), (7), (8), (9), (10), (12), *(15), or (16)* or (m)(2), (4), *(5),* (6), or (7) of section 6103. Any violation of this paragraph shall be a felony punishable by a fine in any amount not exceeding $5,000, or imprisonment of not more than 5 years, or both, together with the costs of prosecution.

* * *

[CCH Explanation at ¶ 1004 and 1047. Committee Reports at ¶ 25,015.]

Amendment Notes

Balanced Budget Act

Act Sec. 11024(b)(8) amended Code Sec. 7213(a)(2) by striking "or (15)" and inserting "(15), or (16)".

For the effective date of the above amendment, see Act Sec. 11721, below.

Act Sec. 11721 provides:

Except as otherwise provided in this title, the provisions of this title shall take effect on the later of October 1, 1997, or the day the District of Columbia Financial Responsibility and Management Assistance Authority certifies that the financial plan and budget for the District government for fiscal year 1998 meet the requirements of section 201(c)(1) of the District of Columbia Financial Responsibility and Management Assistance Act of 1995, as amended by this title.

Taxpayer Browsing Act

Act Sec. 2(b) amended Code Sec. 7213(a)(2) by inserting "(5)," after "(m)(2), (4), ".

The above amendment applies to violations occurring on and after the date of the enactment of this Act.

[¶ 5712A] *CODE SEC. 7213A. UNAUTHORIZED INSPECTION OF RETURNS OR RETURN INFORMATION.*

(a) PROHIBITIONS.—

(1) FEDERAL EMPLOYEES AND OTHER PERSONS.—It shall be unlawful for—

(A) any officer or employee of the United States, or

(B) any person described in section 6103(n) or an officer or employee of any such person,

willfully to inspect, except as authorized in this title, any return or return information.

(2) STATE AND OTHER EMPLOYEES.—It shall be unlawful for any person (not described in paragraph (1)) willfully to inspect, except as authorized in this title, any return or return information acquired by such person or another person under a provision of section 6103 referred to in section 7213(a)(2).

(b) PENALTY.—

(1) IN GENERAL.—Any violation of subsection (a) shall be punishable upon conviction by a fine in any amount not exceeding $1,000, or imprisonment of not more than 1 year, or both, together with the costs of prosecution.

(2) FEDERAL OFFICERS OR EMPLOYEES.—An officer or employee of the United States who is convicted of any violation of subsection (a) shall, in addition to any other punishment, be dismissed from office or discharged from employment.

(c) DEFINITIONS.—For purposes of this section, the terms "inspect", "return", and "return information" have the respective meanings given such terms by section 6103(b).

* * *

[CCH Explanation at ¶ 1004. Committee Reports at ¶ 25,015.]

Amendment Notes

Taxpayer Browsing Act

Act Sec. 2(a) amended part I of subchapter A of chapter 75 by adding after Code Sec. 7213 a new Code Sec. 7213A to read as above.

The above amendment applies to violations occurring on and after the date of the enactment of this Act.

[*Caution: Code Sec. 7232, below, as amended by Act Sec. 1032(e)(12)(A)-(B) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

[¶ 5713] *CODE SEC. 7232. FAILURE TO REGISTER UNDER SECTION 4101, FALSE REPRESENTATIONS OF REGISTRATION STATUS, ETC.*

Every person who fails to register as required by section 4101, or who in connection with any purchase of *any taxable fuel (as defined in section 4083),* or aviation fuel falsely represents himself to be

registered as provided by section 4101, or who willfully makes any false statement in an application for registration under section 4101, shall, upon conviction thereof, be fined not more than $5,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

* * *

[CCH Explanation at ¶ 1211. Committee Reports at ¶ 11,285.]

Amendment Notes

Act Sec. 1032(e)(12)(A) amended Code Sec. 7232 by striking "gasoline, lubricating oil, diesel fuel" [sic] and inserting "any taxable fuel (as defined in section 4083)".

Act Sec. 1032(e)(12)(B) amended Code Sec. 7232 amended the heading to read as above. Prior to amendment, the section heading for Code Sec. 7232 read as follows:

SEC. 7232. FAILURE TO REGISTER, OR FALSE STATEMENT BY MANUFACTURER OR PRODUCER OF GASOLINE, DIESEL FUEL, OR AVIATION FUEL.

The above amendments are effective on July 1, 1998.

[¶ 5715] CODE SEC. 7421. PROHIBITION OF SUITS TO RESTRAIN ASSESSMENT OR COLLECTION.

(a) TAX.—Except as provided in sections 6212(a) and (c), 6213(a), *6225(b), 6246(b),* 6672(b), 6694(c), 7426(a) and (b)(1), *7429(b), and 7436,* no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.

* * *

[CCH Explanation at ¶ 421–427, 455 and 1031. Committee Reports at ¶ 12,245, 12,370 and 12,985.]

Amendment Notes

Act Sec. 1222(b)(1) amended Code Sec. 7421(a) by inserting "6246(b)," after "6213(a),".

The above amendment applies to partnership tax years ending on or after December 31, 1997.

Act Sec. 1239(e)(3) amended Code Sec. 7421(a), as amended by Act Sec. 1222, by inserting "6225(b)," after "6213(a),".

The above amendment applies to partnership tax years ending after the date of the enactment of this Act.

Act Sec. 1454(b)(2) amended Code Sec. 7421(a) by striking "and 7429(b)" and inserting "7429(b), and 7436".

The above amendment is effective on the date of the enactment of this Act.

[¶ 5717] CODE SEC. 7430. AWARDING OF COSTS AND CERTAIN FEES.

* * *

(b) LIMITATIONS.—

* * *

(5)[(4)] PERIOD FOR APPLYING TO IRS FOR ADMINISTRATIVE COSTS.—An award may be made under subsection (a) by the Internal Revenue Service for reasonable administrative costs only if the prevailing party files an application with the Internal Revenue Service for such costs before the 91st day after the date on which the final decision of the Internal Revenue Service as to the determination of the tax, interest, or penalty is mailed to such party.

Amendment Notes

Act Sec. 1285(b) amended Code Sec. 7430(b) by adding at the end a new paragraph (5)[(4)] to read as above.

The above amendment applies to civil actions or proceedings commenced after the date of the enactment of this Act.

(c) DEFINITIONS.—For purposes of this section—

* * *

(4) PREVAILING PARTY.—

* * *

(D) SPECIAL RULES FOR APPLYING NET WORTH REQUIREMENT.—In applying the requirements of section 2412(d)(2)(B) of title 28, United States Code, for purposes of subparagraph (A)(iii) of this paragraph—

(i) the net worth limitation in clause (i) of such section shall apply to—

(I) an estate but shall be determined as of the date of the decedent's death, and

(II) a trust but shall be determined as of the last day of the taxable year involved in the proceeding, and

(ii) individuals filing a joint return shall be treated as separate individuals for purposes of clause (i) of such section.

* * *

Amendment Notes

Act Sec. 1453(a) amended Code Sec. 7430(c)(4) by adding at the end a new subparagraph (D) to read as above.

The above amendment applies to proceedings commenced after the date of the enactment of this Act.

(f) RIGHT OF APPEAL.—

* * *

(2) ADMINISTRATIVE PROCEEDINGS.—A decision granting or denying (in whole or in part) an award for reasonable administrative costs under subsection (a) by the Internal Revenue Service shall be subject to *the filing of a petition for review with* the Tax Court under rules similar to the rules under section 7463 (without regard to the amount in dispute). *If the Secretary sends by certified or registered mail a notice of such decision to the petitioner, no proceeding in the Tax Court may be initiated under this paragraph unless such petition is filed before the 91st day after the date of such mailing.*

(3) APPEAL OF TAX COURT DECISION.—An order of the Tax Court disposing of a petition under paragraph (2) shall be reviewable in the same manner as a decision of the Tax Court, but only with respect to the matters determined in such order.

* * *

[CCH Explanation at ¶ 1016, 1034 and 1037. Committee Reports at ¶ 12,555 and 12,965.]

Amendment Notes

Act Sec. 1285(a) amended Code Sec. 7430(f) by adding at the end a new paragraph (3) to read as above.

Act Sec. 1285(c)(1)-(2) amended Code Sec. 7430(f)(2) by striking "appeal to" and inserting "the filing of a petition for review with", and by adding at the end a new sentence to read as above.

The above amendments apply to civil actions or proceedings commenced after the date of the enactment of this Act.

[¶ 5719] CODE SEC. 7431. CIVIL DAMAGES FOR UNAUTHORIZED *INSPECTION OR* DISCLOSURE OF RETURNS AND RETURN INFORMATION.

(a) IN GENERAL.—

(1) *INSPECTION OR DISCLOSURE* BY EMPLOYEE OF UNITED STATES.—If any officer or employee of the United States knowingly, or by reason of negligence, *inspects or discloses* any return or return information with respect to a taxpayer in violation of any provision of section 6103, such taxpayer may bring a civil action for damages against the United States in a district court of the United States.

(2) *INSPECTION OR DISCLOSURE* BY A PERSON WHO IS NOT AN EMPLOYEE OF UNITED STATES.—If any person who is not an officer or employee of the United States knowingly, or by reason of negligence, *inspects or discloses* any return or return information with respect to a taxpayer in violation of any provision of section 6103, such taxpayer may bring a civil action for damages against such person in a district court of the United States.

Amendment Notes

Taxpayer Browsing Act

Act Sec. 3(a)(1)-(2) amended Code Sec. 7431(a)(1) and (2) by striking "DISCLOSURE" in the heading and inserting "INSPECTION OR DISCLOSURE" and by striking "discloses" and inserting "inspects or discloses" in the text.

Act Sec. 3(d)(4) amended the heading of Code Sec. 7431 by inserting "**INSPECTION OR**" before "**DISCLOSURE**".

The above amendments apply to inspections and disclosures occurring on and after the date of the enactment of this Act.

(b) EXCEPTIONS.—No liability shall arise under this section with respect to any inspection or disclosure—

(1) which results from a good faith, but erroneous, interpretation of section 6103, or

(2) which is requested by the taxpayer.

Amendment Notes

Taxpayer Browsing Act

Act Sec. 3(c) amended Code Sec. 7431(b) to read as above. Prior to amendment, Code Sec. 7431(b) read as follows:

(b) NO LIABILITY FOR GOOD FAITH BUT ERRONEOUS INTERPRETATION.—No liability shall arise under this section with respect to any disclosure which results from a good faith, but erroneous, interpretation of section 6103.

The above amendment applies to inspections and disclosures occurring on and after the date of the enactment of this Act.

(c) DAMAGES.—In any action brought under subsection (a), upon a finding of liability on the part of the defendant, the defendant shall be liable to the plaintiff in an amount equal to the sum of—

(1) the greater of—

(A) $1,000 for each act of unauthorized *inspection or* disclosure of a return or return information with respect to which such defendant is found liable, or

(B) the sum of—

(i) the actual damages sustained by the plaintiff as a result of such unauthorized *inspection or* disclosure, plus

(ii) in the case of a *willful inspection or disclosure or an inspection or disclosure* which is the result of gross negligence, punitive damages, plus

(2) the costs of the action.

Amendment Notes

Taxpayer Browsing Act

Act Sec. 3(d)(1) amended Code Sec. 7431(c)(1)(A) and (B)(i) by inserting "inspection or" before "disclosure".

Act Sec. 3(d)(2) amended Code Sec. 7431(c)(1)(B)(ii) by striking "willful disclosure or a disclosure" and inserting "willful inspection or disclosure or an inspection or disclosure".

The above amendments apply to inspections and disclosures occurring on and after the date of the enactment of this Act.

(d) PERIOD FOR BRINGING ACTION.—Notwithstanding any other provision of law, an action to enforce any liability created under this section may be brought, without regard to the amount in controversy, at any time within 2 years after the date of discovery by the plaintiff of the unauthorized *inspection or* disclosure.

Amendment Notes

Taxpayer Browsing Act

Act Sec. 3(d)(1) amended Code Sec. 7431(d) by inserting "inspection or" before "disclosure".

The above amendment applies to inspections and disclosures occurring on and after the date of the enactment of this Act.

(e) NOTIFICATION OF UNLAWFUL INSPECTION AND DISCLOSURE.—If any person is criminally charged by indictment or information with inspection or disclosure of a taxpayer's return or return information in violation of—

(1) paragraph (1) or (2) of section 7213(a),

(2) section 7213A(a), or

(3) subparagraph (B) of section 1030(a)(2) of title 18, United States Code,

the Secretary shall notify such taxpayer as soon as practicable of such inspection or disclosure.

Amendment Notes

Taxpayer Browsing Act

Act Sec. 3(b) amended Code Sec. 7431 by redesignating subsections (e) and (f) as subsections (f) and (g), respectively, and by inserting after subsection (d) a new subsection (e) to read as above.

The above amendment applies to inspections and disclosures occurring on and after the date of the enactment of this Act.

(f) DEFINITIONS.—For purposes of this section, the terms "inspect", "inspection", "return", and "return information" have the respective meanings given such terms by section 6103(b).

Amendment Notes

Taxpayer Browsing Act

Act Sec. 3(b) amended Code Sec. 7431 by redesignating subsection (e) as subsection (f).

Act Sec. 3(d)(3) amended Code Sec. 7431(f), as redesignated by Act Sec. 3(b), to read as above. Prior to amendment, Code Sec. 7431(f) read as follows:

(f) RETURN; RETURN INFORMATION.—For purposes of this section, the terms "return" and "return information" have the respective meanings given such terms in section 6103(b).

The above amendments apply to inspections and disclosures occurring on and after the date of the enactment of this Act.

(g) EXTENSION TO INFORMATION OBTAINED UNDER SECTION 3406.—For purposes of this section—

(1) any information obtained under section 3406 (including information with respect to any payee certification failure under subsection (d) thereof) shall be treated as return information, and

(2) *any inspection or use* of such information other than for purposes of meeting any requirement under section 3406 or (subject to the safeguards set forth in section 6103) for purposes permitted under section 6103 shall be treated as a violation of section 6103.

For purposes of subsection (b), the reference to section 6103 shall be treated as including a reference to section 3406.

Amendment Notes

Taxpayer Browsing Act

Act Sec. 3(b) amended Code Sec. 7431 by redesignating subsection (f) as subsection (g).

Act Sec. 3(d)(6) amended Code Sec. 7431(g)(2), as redesignated by Act Sec. 3(b), by striking "any use" and inserting "any inspection or use".

The above amendments apply to inspections and disclosures occurring on and after the date of the enactment of this Act.

[*Caution: Code Sec. 7431(g)[(h)], below, as added by Act Sec. 1205(c)(2) of the Taxpayer Relief Act of 1997, is effective on the day 9 months after the date of the enactment of the Act.—CCH.*]

(g)[(h)] SPECIAL RULE FOR INFORMATION OBTAINED UNDER SECTION 6103(k)(8).—For purposes of this section, any reference to section 6103 shall be treated as including a reference to section 6311(e).

* * *

[CCH Explanation at ¶ 1007 and 1111. Committee Reports at ¶ 12,140 and 25,025.]

Amendment Notes

Act Sec. 1205(c)(2) amended Code Sec. 7431 by adding at the end a new subsection (g)[(h)] to read as above.

The above amendment takes effect on the day 9 months after the date of the enactment of this Act.

[¶ 5721] *CODE SEC. 7436. PROCEEDINGS FOR DETERMINATION OF EMPLOYMENT STATUS.*

(a) CREATION OF REMEDY.—If, in connection with an audit of any person, there is an actual controversy involving a determination by the Secretary as part of an examination that—

(1) one or more individuals performing services for such person are employees of such person for purposes of subtitle C, or

(2) such person is not entitled to the treatment under subsection (a) of section 530 of the Revenue Act of 1978 with respect to such an individual,

upon the filing of an appropriate pleading, the Tax Court may determine whether such a determination by the Secretary is correct. Any such redetermination by the Tax Court shall have the force and effect of a decision of the Tax Court and shall be reviewable as such.

(b) LIMITATIONS.—

(1) PETITIONER.—A pleading may be filed under this section only by the person for whom the services are performed.

(2) TIME FOR FILING ACTION.—If the Secretary sends by certified or registered mail notice to the petitioner of a determination by the Secretary described in subsection (a), no proceeding may be initiated under this section with respect to such determination unless the pleading is filed before the 91st day after the date of such mailing.

(3) NO ADVERSE INFERENCE FROM TREATMENT WHILE ACTION IS PENDING.—If, during the pendency of any proceeding brought under this section, the petitioner changes his treatment for employment tax purposes of any individual whose employment status as an employee is involved in such proceeding (or of any individual holding a substantially similar position) to treatment as an employee, such change shall not be taken into account in the Tax Court's determination under this section.

(c) SMALL CASE PROCEDURES.—

(1) IN GENERAL.—At the option of the petitioner, concurred in by the Tax Court or a division thereof before the hearing of the case, proceedings under this section may (notwithstanding the provisions of section 7453) be conducted subject to the rules of evidence, practice, and procedure applicable under section 7463 if the amount of employment taxes placed in dispute is $10,000 or less for each calendar quarter involved.

(2) FINALITY OF DECISIONS.—A decision entered in any proceeding conducted under this subsection shall not be reviewed in any other court and shall not be treated as a precedent for any other case not involving the same petitioner and the same determinations.

(3) CERTAIN RULES TO APPLY.—Rules similar to the rules of the last sentence of subsection (a), and subsections (c), (d), and (e), of section 7463 shall apply to proceedings conducted under this subsection.

(d) SPECIAL RULES.—

(1) RESTRICTIONS ON ASSESSMENT AND COLLECTION PENDING ACTION, ETC.—The principles of subsections (a), (b), (c), (d), and (f) of section 6213, section 6214(a), section 6215, section 6503(a), section 6512, and section 7481 shall apply to proceedings brought under this section in the same manner as if the Secretary's determination described in subsection (a) were a notice of deficiency.

(2) Awarding of costs and certain fees.—Section 7430 shall apply to proceedings brought under this section.

(e) Employment Tax.—The term "employment tax" means any tax imposed by subtitle C.

[CCH Explanation at ¶ 1031. Committee Reports at ¶ 12,985.]

Amendment Notes

Act Sec. 1454(a) amended subchapter B of chapter 76 by redesignating Code Sec. 7436 as Code Sec. 7437 and by inserting after Code Sec. 7435 a new Code Sec. 7436 to read as above.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5723] CODE SEC. *7437.* CROSS REFERENCES.

* * *

[CCH Explanation at ¶ 1031. Committee Reports at ¶ 12,985.]

Amendment Notes

Act Sec. 1454(a) amended subchapter B of chapter 76 by redesignating Code Sec. 7436 as Code Sec. 7437.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5725] CODE SEC. 7453. RULES OF PRACTICE, PROCEDURE, AND EVIDENCE.

Except in the case of proceedings conducted under *section 7436(c) or 7463*, the proceedings of the Tax Court and its divisions shall be conducted in accordance with such rules of practice and procedure (other than rules of evidence) as the Tax Court may prescribe and in accordance with the rules of evidence applicable in trials without a jury in the United States District Court of the District of Columbia.

* * *

[CCH Explanation at ¶ 1031. Committee Reports at ¶ 12,985.]

Amendment Notes

Act Sec. 1454(b)(3) amended Code Sec. 7453 by striking "section 7463" and inserting "section 7436(c) or 7463".

The above amendment is effective on the date of the enactment of this Act.

[¶ 5727] CODE SEC. 7459. REPORTS AND DECISIONS.

* * *

(c) Date of Decision.—A decision of the Tax Court (except a decision dismissing a proceeding for lack of jurisdiction) shall be held to be rendered upon the date that an order specifying the amount of the deficiency is entered in the records of the Tax Court or, in the case of a declaratory judgment proceeding under part IV of this subchapter, or under section 7428 or in the case of an action brought under section 6226, *6228(a), 6234(c)[,] 6247, or 6252*, the date of the court's order entering the decision. If the Tax Court dismisses a proceeding for reasons other than lack of jurisdiction and is unable from the record to determine the amount of the deficiency determined by the Secretary, or if the Tax Court dismisses a proceeding for lack of jurisdiction, an order to that effect shall be entered in the records of the Tax Court, and the decision of the Tax Court shall be held to be rendered upon the date of such entry.

* * *

[CCH Explanation at ¶ 421–427 and 455. Committee Reports at ¶ 12,245 and 12,370.]

Amendment Notes

Act Sec. 1222(b)(2) amended Code Sec. 7459(c) by striking "or section 6228(a)" and inserting ", 6228(a), 6247, or 6252".

The above amendment applies to partnership tax years ending on or after December 31, 1997.

Act Sec. 1239(e)(1) amended Code Sec. 7459(c) by striking "or section 6228(a)" [sic] and inserting ", 6228(a), or [sic] 6234(c)[,]".

The above amendment applies to partnership tax years ending after the date of the enactment of this Act.

[¶ 5729] *CODE SEC. 7477. DECLARATORY JUDGMENTS RELATING TO VALUE OF CERTAIN GIFTS.*

(a) Creation of Remedy.—In a case of an actual controversy involving a determination by the Secretary of the value of any gift shown on the return of tax imposed by chapter 12 or disclosed on such return or in any statement attached to such return, upon the filing of an appropriate pleading, the Tax Court may make a declaration of the value of such gift. Any such declaration shall have the force and effect of a decision of the Tax Court and shall be reviewable as such.

(b) Limitations.—

(1) Petitioner.—A pleading may be filed under this section only by the donor.

(2) Exhaustion of administrative remedies.—The court shall not issue a declaratory judgment or decree under this section in any proceeding unless it determines that the petitioner has exhausted all available administrative remedies within the Internal Revenue Service.

(3) Time for bringing action.—If the Secretary sends by certified or registered mail notice of his determination as described in subsection (a) to the petitioner, no proceeding may be initiated under this section unless the pleading is filed before the 91st day after the date of such mailing.

* * *

[CCH Explanation at ¶ 255. Committee Reports at ¶ 10,395.]

Amendment Notes

Act Sec. 506(c)(1) amended part IV of subchapter C of chapter 76 by inserting after Code Sec. 7476 a new Code Sec. 7477 to read as above.

The above amendment applies to gifts made after the date of the enactment of this Act.

[¶ 5731] *CODE SEC. 7479. DECLARATORY JUDGMENTS RELATING TO ELIGIBILITY OF ESTATE WITH RESPECT TO INSTALLMENT PAYMENTS UNDER SECTION 6166.*

(a) Creation of Remedy.—In a case of actual controversy involving a determination by the Secretary of (or a failure by the Secretary to make a determination with respect to)—

(1) whether an election may be made under section 6166 (relating to extension of time for payment of estate tax where estate consists largely of interest in closely held business) with respect to an estate, or

(2) whether the extension of time for payment of tax provided in section 6166(a) has ceased to apply with respect to an estate,

upon the filing of an appropriate pleading, the Tax Court may make a declaration with respect to whether such election may be made or whether such extension has ceased to apply. Any such declaration shall have the force and effect of a decision of the Tax Court and shall be reviewable as such.

(b) Limitations.—

(1) Petitioner.—A pleading may be filed under this section, with respect to any estate, only—

(A) by the executor of such estate, or

(B) by any person who has assumed an obligation to make payments under section 6166 with respect to such estate (but only if each other such person is joined as a party).

(2) Exhaustion of administrative remedies.—The court shall not issue a declaratory judgment or decree under this section in any proceeding unless it determines that the petitioner has exhausted all available administrative remedies within the Internal Revenue Service. A petitioner shall be deemed to have exhausted its administrative remedies with respect to a failure of the Secretary to make a determination at the expiration of 180 days after the date on which the request for such determination was made if the petitioner has taken, in a timely manner, all reasonable steps to secure such determination.

(3) Time for bringing action.—If the Secretary sends by certified or registered mail notice of his determination as described in subsection (a) to the petitioner, no proceeding may be initiated under this section unless the pleading is filed before the 91st day after the date of such mailing.

[CCH Explanation at ¶ 225. Committee Reports at ¶ 10,390.]

Amendment Notes

Act Sec. 505(a) amended part IV of subchapter C of chapter 76 by adding at the end a new Code Sec. 7479 to read as above.

The above amendment applies to the estates of decedents dying after the date of the enactment of this Act.

[¶ 5733] CODE SEC. 7481. DATE WHEN TAX COURT DECISION BECOMES FINAL.

* * *

(b) Nonreviewable Decisions.—The decision of the Tax Court in a proceeding conducted under *section 7436(c) or 7463* shall become final upon the expiration of 90 days after the decision is entered.

Amendment Notes

Act Sec. 1454(b)(3) amended Code Sec. 7481(b) by striking "section 7463" and inserting "section 7436(c) or 7463".

The above amendment is effective on the date of the enactment of this Act.

(c) Jurisdiction Over Interest Determinations.—

(1) In general.—Notwithstanding subsection (a), if, within 1 year after the date the decision of the Tax Court becomes final under subsection (a) in a case to which this subsection applies, the taxpayer files a motion in the Tax Court for a redetermination of the amount of interest involved, then the Tax Court may reopen the case solely to determine whether the taxpayer has made an

overpayment of such interest or the Secretary has made an underpayment of such interest and the amount thereof.

(2) CASES TO WHICH THIS SUBSECTION APPLIES.—This subsection shall apply where—

(A)(i) an assessment has been made by the Secretary under section 6215 which includes interest as imposed by this title, and

(ii) the taxpayer has paid the entire amount of the deficiency plus interest claimed by the Secretary, and

(B) the Tax Court finds under section 6512(b) that the taxpayer has made an overpayment.

(3) SPECIAL RULES.—If the Tax Court determines under this subsection that the taxpayer has made an overpayment of interest or that the Secretary has made an underpayment of interest, then that determination shall be treated under section 6512(b)(1) as a determination of an overpayment of tax. An order of the Tax Court redetermining interest, when entered upon the records of the court, shall be reviewable in the same manner as a decision of the Tax Court.

[CCH Explanation at ¶ 1028 and 1031. Committee Reports at ¶ 12,960 and 12,985.]

Amendment Notes

Act Sec. 1452(a) amended Code Sec. 7481(c) to read as above. Prior to amendment, Code Sec. 7481(c) read as follows:

(c) JURISDICTION OVER INTEREST DETERMINATIONS.—Notwithstanding subsection (a), if—

(1) an assessment has been made by the Secretary under section 6215 which includes interest as imposed by this title,

(2) the taxpayer has paid the entire amount of the deficiency plus interest claimed by the Secretary, and

(3) within 1 year after the date the decision of the Tax Court becomes final under subsection (a), the taxpayer files a petition in the Tax Court for a determination that the amount of interest claimed by the Secretary exceeds the amount of interest imposed by this title,

then the Tax Court may reopen the case solely to determine whether the taxpayer has made an overpayment of such interest and the amount of any such overpayment. If the Tax Court determines under this subsection that the taxpayer has made an overpayment of interest, then that determination shall be treated under section 6512(b)(1) as a determination of an overpayment of tax. An order of the Tax Court redetermining the interest due, when entered upon the records of the court, shall be reviewable in the same manner as a decision of the Tax Court.

The above amendment is effective on the date of the enactment of this Act.

[¶ 5735] CODE SEC. 7482. COURTS OF REVIEW.

* * *

(b) VENUE.—

(1) IN GENERAL.—Except as otherwise provided in paragraphs (2) and (3), such decisions may be reviewed by the United States court of appeals for the circuit in which is located—

* * *

(D) in the case of an organization seeking a declaratory decision under section 7428, the principal office or agency of the organization,

(E) in the case of a petition under section 6226, *6228(a), 6247, or 6252,* the principal place of business of the partnership, *or*

(F) in the case of a petition under section 6234(c)—

(i) the legal residence of the petitioner if the petitioner is not a corporation, and

(ii) the place or office applicable under subparagraph (B) if the petitioner is a corporation.

If for any reason no subparagraph of the preceding sentence applies, then such decisions may be reviewed by the Court of Appeals for the District of Columbia. For purposes of this paragraph, the legal residence, principal place of business, or principal office or agency referred to herein shall be determined as of the time the petition seeking redetermination of tax liability was filed with the Tax Court or as of the time the petition seeking a declaratory decision under section 7428 or 7476 or the petition under section 6226, *6228(a), or 6234(c),* was filed with the Tax Court.

* * *

[CCH Explanation at ¶ 421–427 and 455. Committee Reports at ¶ 12,245 and 12,370.]

Amendment Notes

Act Sec. 1222(b)(3) amended Code Sec. 7482(b)(1)(E) by striking "or 6228(a)" and inserting ", 6228(a), 6247, or 6252".

The above amendment applies to partnership tax years ending on or after December 31, 1997.

Act Sec. 1239(d)(1) amended Code Sec. 7482(b)(1) by striking "or" at the end of subparagraph (D), by striking the period at the end of subparagraph (E) and inserting ", or", and by inserting after subparagraph (E) a new subparagraph (F) to read as above.

Act Sec. 1239(d)(2) amended Code Sec. 7482(b)(1) by striking "or 6228(a)" in the last sentence and inserting ", 6228(a), or 6234(c)".

The above amendments apply to partnership tax years ending after the date of the enactment of this Act.

[¶ 5737] CODE SEC. 7485. BOND TO STAY ASSESSMENT AND COLLECTION.

* * *

(b) *Bond in Case of Appeal of Certain Partnership-Related Decisions.*—The condition of subsection (a) shall be satisfied if a partner duly files notice of appeal from a decision under section 6226, *6228(a), 6247, or 6252* and on or before the time the notice of appeal is filed with the Tax Court, a bond in an amount fixed by the Tax Court is filed, and with surety approved by the Tax Court, conditioned upon the payment of deficiencies attributable to the partnership items to which that decision relates as finally determined, together with any interest, *penalties,* additional amounts, or additions to the tax provided by law. Unless otherwise stipulated by the parties, the amount fixed by the Tax Court shall be based upon its estimate of the *aggregate liability of the parties to the action.*

* * *

[CCH Explanation at ¶ 421–427 and 459. Committee Reports at ¶ 12,245 and 12,380.]

Amendment Notes

Act Sec. 1222(b)(4)(A) amended Code Sec. 7485(b) by striking "or 6228(a)" and inserting ", 6228(a), 6247, or 6252".

Act Sec. 1222(b)(4)(B) amended the heading of Code Sec. 7485(b) to read as above. Prior to amendment, the heading for Code Sec. 7485(b) read as follows:

(b) Bond in Case of Appeal of Decision Under Section 6226 or Section 6228(a).—

The above amendments apply to partnership tax years ending on or after December 31, 1997.

Act Sec. 1241(a)(1)-(2) amended Code Sec. 7485(b) by inserting "penalties," after "any interest,", and by striking "aggregate of such deficiencies" and inserting "aggregate liability of the parties to the action".

The above amendment is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) [generally effective for partnership tax years beginning after September 3, 1982.—CCH.].

[¶ 5739] *CODE SEC. 7508A. AUTHORITY TO POSTPONE CERTAIN TAX-RELATED DEADLINES BY REASON OF PRESIDENTIALLY DECLARED DISASTER.*

(a) In General.—In the case of a taxpayer determined by the Secretary to be affected by a Presidentially declared disaster (as defined by section 1033(h)(3)), the Secretary may prescribe regulations under which a period of up to 90 days may be disregarded in determining, under the internal revenue laws, in respect of any tax liability (including any penalty, additional amount, or addition to the tax) of such taxpayer—

(1) whether any of the acts described in paragraph (1) of section 7508(a) were performed within the time prescribed therefor, and

(2) the amount of any credit or refund.

(b) Interest on Overpayments and Underpayments.—Subsection (a) shall not apply for the purpose of determining interest on any overpayment or underpayment.

* * *

[CCH Explanation at ¶ 1067. Committee Reports at ¶ 10,585.]

Amendment Notes

Act Sec. 911(a) amended chapter 77 by inserting after Code Sec. 7508 a new Code Sec. 7508A to read as above.

The above amendment applies with respect to any period for performing an act that has not expired before the date of the enactment of this Act.

[¶ 5741] CODE SEC. 7518. TAX INCENTIVES RELATING TO MERCHANT MARINE CAPITAL CONSTRUCTION FUNDS.

* * *

(g) Tax Treatment of Nonqualified Withdrawals.—

* * *

(6) Nonqualified withdrawals taxed at highest marginal rate.—

(A) In general.—In the case of any taxable year for which there is a nonqualified withdrawal (including any amount so treated under paragraph (5)), the tax imposed by chapter 1 shall be determined—

(i) by excluding such withdrawal from gross income, and

(ii) by increasing the tax imposed by chapter 1 by the product of the amount of such withdrawal and the highest rate of tax specified in section 1 (section 11 in the case of a corporation).

With respect to the portion of any nonqualified withdrawal made out of the capital gain account during a taxable year to which section 1(h) or 1201(a) applies, the rate of tax taken into account under the preceding sentence shall not exceed *20 percent* (34 percent in the case of a corporation).

* * *

[CCH Explanation at ¶ 303. Committee Reports at ¶ 10,295.]

Amendment Notes

Act Sec. 311(c)(2) amended Code Sec. 7518(g)(6)(A) by striking "28 percent" in the second sentence and inserting "20 percent".

The above amendment applies to tax years ending after May 6, 1997.

[¶ 5743] CODE SEC. 7519. REQUIRED PAYMENTS FOR ENTITIES ELECTING NOT TO HAVE REQUIRED TAXABLE YEAR.

* * *

(f) ADMINISTRATIVE PROVISIONS.—

* * *

(4) PENALTIES.—

(A) IN GENERAL.—In the case of any failure by any person to pay on the date prescribed therefor any amount required by this section, there shall be imposed on such person a penalty of 10 percent of the underpayment. For purposes of the preceding sentence, the term "underpayment" means the excess of the amount of the payment required under this section over the amount (if any) of such payment paid on or before the date prescribed therefor. *No penalty shall be imposed under this subparagraph on any failure which is shown to be due to reasonable cause and not willful neglect.*

* * *

[CCH Explanation at ¶ 1001. Committee Reports at ¶ 12,535.]

Amendment Notes

Act Sec. 1281(d) amended Code Sec. 7519(f)(4)(A) by adding at the end a new sentence to read as above.

The above amendment applies to tax years beginning after the date of the enactment of this Act.

[¶ 5745] CODE SEC. 7701. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * *

(4) DOMESTIC.—The term "domestic" when applied to a corporation or partnership means created or organized in the United States or under the law of the United States or of any State *unless, in the case of a partnership, the Secretary provides otherwise by regulations.*

* * *

(30) UNITED STATES PERSON.—The term "United States person" means—

* * *

(E) any trust if—

* * *

(ii) one or more United States *persons* have the authority to control all substantial decisions of the trust.

* * *

Amendment Notes

Act Sec. 1151(a) amended Code Sec. 7701(a)(4) by inserting before the period "unless, in the case of a partnership, the Secretary provides otherwise by regulations".

The above amendment is effective on the date of the amendment of this Act. For a special rule, see Act Sec. 1151(b).

Act Sec. 1151(b) provides:

(b) EFFECTIVE DATE.—Any regulations issued with respect to the amendment made by subsection (a) shall apply to partnerships created or organized after the date determined under section 7805(b) of the Internal Revenue Code of 1986 (without regard to paragraph (2) thereof) with respect to such regulations.

Act Sec. 1601(i)(3)(A) amended Code Sec. 7701(a)(30)(E)(ii) by striking "fiduciaries" and inserting "persons".

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [generally effective for tax years beginning after December 31, 1996.—CCH.].

(b) DEFINITION OF RESIDENT ALIEN AND NONRESIDENT ALIEN.—

* * *

(7) PRESENCE IN THE UNITED STATES.—For purposes of this subsection—

(A) IN GENERAL.—Except as provided in subparagraph (B), *(C), or (D)* an individual shall be treated as present in the United States on any day if such individual is physically present in the United States at any time during such day.

* * *

(D) CREW MEMBERS TEMPORARILY PRESENT.—An individual who is temporarily present in the United States on any day as a regular member of the crew of a foreign vessel engaged in transportation between the United States and a foreign country or a possession of the United States shall not be treated as present in the United States on such day unless such individual otherwise engages in any trade or business in the United States on such day.

* * *

[CCH Explanation at ¶ 467, 965 and 975. Committee Reports at ¶ 11,815, 11,880 and 13,720.]

Amendment Notes

Act Sec. 1174(b)(1) amended Code Sec. 7701(b)(7) by adding at the end a new subparagraph (D) to read as above.

Act Sec. 1174(b)(2) amended Code Sec. 7701(b)(7)(A) by striking "or (C)" and inserting ", (C), or (D)".

The above amendments apply to tax years beginning after December 31, 1997.

[¶ 5747] CODE SEC. 7702B. TREATMENT OF QUALIFIED LONG-TERM CARE INSURANCE.

* * *

(c) QUALIFIED LONG-TERM CARE SERVICES.—For purposes of this section—

* * *

(2) CHRONICALLY ILL INDIVIDUAL.—

* * *

(B) ACTIVITIES OF DAILY LIVING.—For purposes of subparagraph (A), each of the following is an activity of daily living:

(i) Eating.

(ii) Toileting.

(iii) Transferring.

(iv) Bathing.

(v) Dressing.

(vi) Continence.

A contract shall not be treated as a qualified long-term care insurance contract unless the determination of whether an individual is a chronically ill individual *described in subparagraph (A)(i)* takes into account at least 5 of such activities.

* * *

Amendment Notes

Act Sec. 1602(b) amended Code Sec. 7702B(c)(2)(B) by inserting "described in subparagraph (A)(i)" after "chronically ill individual" in the last sentence.

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which such amendment relates [generally effective for contracts issued after December 31, 1996.—CCH.].

(g) CONSUMER PROTECTION PROVISIONS.—

* * *

(4) NONFORFEITURE REQUIREMENTS.—

* * *

(B) REQUIREMENTS OF PROVISION.—The nonforfeiture provision required under subparagraph (A) shall meet the following requirements:

(i) The nonforfeiture provision shall be appropriately captioned.

(ii) The nonforfeiture provision shall provide for a benefit available in the event of a default in the payment of any premiums and the amount of the benefit may be adjusted

subsequent to being initially granted only as necessary to reflect changes in claims, persistency, and interest as reflected in changes in rates for premium paying contracts approved by the *appropriate State regulatory agency* for the same contract form.

(iii) The nonforfeiture provision shall provide at least one of the following:

(I) Reduced paid-up insurance.

(II) Extended term insurance.

(III) Shortened benefit period.

(IV) Other similar offerings approved by the *appropriate State regulatory agency.*

* * *

[CCH Explanation at ¶ 835 and 841. Committee Reports at ¶ 13,815 and 13,830.]

Amendment Notes

Act Sec. 1602(e) amended Code Sec. 7702B(g)(4)(B)(ii)-(iii) by striking "Secretary" and inserting "appropriate State regulatory agency".

The above amendment is effective as if included in the provision of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) to which such amendment relates [generally effective for contracts issued after December 31, 1996.—CCH.].

[¶ 5749] CODE SEC. 7704. CERTAIN PUBLICLY TRADED PARTNERSHIPS TREATED AS CORPORATIONS.

* * *

(g) EXCEPTION FOR ELECTING 1987 PARTNERSHIPS.—

(1) IN GENERAL.—Subsection (a) shall not apply to an electing 1987 partnership.

(2) ELECTING 1987 PARTNERSHIP.—For purposes of this subsection, the term "electing 1987 partnership" means any publicly traded partnership if—

(A) such partnership is an existing partnership (as defined in section 10211(c)(2) of the Revenue Reconciliation Act of 1987),

(B) subsection (a) has not applied (and without regard to subsection (c)(1) would not have applied) to such partnership for all prior taxable years beginning after December 31, 1987, and before January 1, 1998, and

(C) such partnership elects the application of this subsection, and consents to the application of the tax imposed by paragraph (3), for its first taxable year beginning after December 31, 1997.

A partnership which, but for this sentence, would be treated as an electing 1987 partnership shall cease to be so treated (and the election under subparagraph (C) shall cease to be in effect) as of the 1st day after December 31, 1997, on which there has been an addition of a substantial new line of business with respect to such partnership.

(3) ADDITIONAL TAX ON ELECTING PARTNERSHIPS.—

(A) IMPOSITION OF TAX.—There is hereby imposed for each taxable year on the income of each electing 1987 partnership a tax equal to 3.5 percent of such partnership's gross income for the taxable year from the active conduct of trades and businesses by the partnership.

(B) ADJUSTMENTS IN THE CASE OF TIERED PARTNERSHIPS.—For purposes of this paragraph, in the case of a partnership which is a partner in another partnership, the gross income referred to in subparagraph (A) shall include the partnership's distributive share of the gross income of such other partnership from the active conduct of trades and businesses of such other partnership. A similar rule shall apply in the case of lower-tiered partnerships.

(C) TREATMENT OF TAX.—For purposes of this title, the tax imposed by this paragraph shall be treated as imposed by chapter 1 other than for purposes of determining the amount of any credit allowable under chapter 1.

(4) ELECTION.—An election and consent under this subsection shall apply to the taxable year for which made and all subsequent taxable years unless revoked by the partnership. Such revocation may be made without the consent of the Secretary, but, once so revoked, may not be reinstated.

* * *

[CCH Explanation at ¶ 401. Committee Reports at ¶ 10,850.]

Amendment Notes

Act Sec. 964(a) amended Code Sec. 7704 by adding at the end thereof a new subsection (g) to read as above.

The above amendment applies to tax years beginning after December 31, 1997.

[¶ 5751] CODE SEC. 7872. TREATMENT OF LOANS WITH BELOW-MARKET INTEREST RATES.

* * *

(f) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

* * *

(11) TIME FOR DETERMINING RATE APPLICABLE TO EMPLOYEE RELOCATION LOANS.—

(A) IN GENERAL.—In the case of any term loan made by an employer to an employee the proceeds of which are used by the employee to purchase a principal residence (within the meaning of *section 121*), the determination of the applicable Federal rate shall be made as of the date the written contract to purchase such residence was entered into.

* * *

[CCH Explanation at ¶ 129. Committee Reports at ¶ 10,315.]

Amendment Notes

Act Sec. 312(d)(1) amended Code Sec. 7872(f)(11)(A) by striking "section 1034" and inserting "section 121".

The above amendment applies to sales and exchanges after May 6, 1997.

[¶ 5753] CODE SEC. 9502. AIRPORT AND AIRWAY TRUST FUND.

* * *

(b) TRANSFERS TO AIRPORT AND AIRWAY TRUST FUND.—There are hereby appropriated to the Airport and Airway Trust Fund amounts equivalent to—

(1) the taxes received in the Treasury under—

(A) subsections (c) and (e) of section 4041 (relating to aviation fuels),

(B) sections 4261 and 4271 (relating to transportation by air),

(C) section 4081 (relating to gasoline) with respect to aviation gasoline, and

(D) section 4091 (relating to aviation fuel), and

There shall not be taken into account under paragraph (1) so much of the taxes imposed by sections 4081 and 4091 as are determined at the rates specified in section 4081(a)(2)(B) or 4091(b)(2).

* * *

Amendment Notes

Act Sec. 1031(d)(1)(A)-(C) amended Code Sec. 9502(b)(1) by striking "(to the extent that the rate of the tax on such gasoline exceeds 4.3 cents per gallon)" after "aviation gasoline" in subparagraph (C), by striking "to the extent attributable to the Airport and Airway Trust Fund financing rate" after "aviation fuel)" in subparagraph (D), and by adding at the end a new flush sentence to read as above.

The above amendment applies with respect to taxes received in the Treasury on and after October 1, 1997.

(d) EXPENDITURES FROM AIRPORT AND AIRWAY TRUST FUND.—

* * *

(6) TRANSFERS FROM THE AIRPORT AND AIRWAY TRUST FUND ON ACCOUNT OF CERTAIN AIRPORTS.—The Secretary of the Treasury may transfer from the Airport and Airway Trust Fund to the Secretary of Transportation or the Administrator of the Federal Aviation Administration an amount to make a payment to an airport affected by a diversion that is the subject of an administrative action under paragraph (3) or a civil action under paragraph (4) of section 47107(n) of title 49, United States Code.

* * *

Amendment Notes

Act Sec. 1604(g)(5) amended Code Sec. 9502(d) by redesignating the paragraph added by Act Sec. 806 of the Federal Aviation Reauthorization Act of 1996 (P.L. 104-264) as paragraph (6).

The above amendment is effective on the date of the enactment of this Act.

(f) *[Stricken.]*

[CCH Explanation at ¶ 1201. Committee Reports at ¶ 11,275.]

Amendment Notes

Act Sec. 1031(d)(2) amended Code Sec. 9502 by striking subsection (f). Prior to being stricken, Code Sec. 9502(f) read as follows:

(f) DEFINITION OF AIRPORT AND AIRWAY TRUST FUND FINANCING RATE.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the Airport and Airway Trust Fund financing rate is—

(A) in the case of fuel used in an aircraft in noncommercial aviation (as defined in section 4041(c)(2)), 17.5 cents per gallon, and

(B) in the case of fuel used in an aircraft other than in noncommercial aviation (as so defined), zero.

(2) ALCOHOL FUELS.—If the rate of tax on any fuel is determined under section 4091(c), the Airport and Airway Trust Fund financing rate is the excess (if any) of the rate of tax determined under section 4091(c) over 4.4 cents per gallon (10/9 of 4.4 cents per gallon in the case of a rate of tax determined under section 4091(c)(2)).

(3) TERMINATION.—Notwithstanding the preceding provisions of this subsection, the Airport and Airway Trust Fund financing rate shall be zero with respect to taxes imposed during any period that the rate of the tax imposed by section 4091(b)(1) is 4.3 cents per gallon.

The above amendment applies with respect to taxes received in the Treasury on and after October 1, 1997.

[¶ 5755] CODE SEC. 9503. HIGHWAY TRUST FUND.

* * *

(b) TRANSFER TO HIGHWAY TRUST FUND OF AMOUNTS EQUIVALENT TO CERTAIN TAXES.—

(1) IN GENERAL.—There are hereby appropriated to the Highway Trust Fund amounts equivalent to the taxes received in the Treasury before October 1, 1999, under the following provisions—

* * *

[*Caution: Code Sec. 9503(b)(1)(E), below, as amended by Act Sec. 1032(e)(13) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

(E) section 4081 (relating to tax on gasoline, *diesel fuel, and kerosene*), and

* * *

(4) CERTAIN TAXES NOT TRANSFERRED TO HIGHWAY TRUST FUND.—For purposes of paragraphs (1) and (2), there shall not be taken into account the taxes imposed by—

(A) section 4041(d),

(B) section 4081 to the extent attributable to the rate specified in section 4081(a)(2)(B),

(C) section 4041 or 4081 to the extent attributable to fuel used in a train,

(D) in the case of fuels used as described in paragraph (4)(D), (5)(B), or (6)(D) of subsection (c), section 4041 or 4081—

(i) with respect to so much of the rate of tax on gasoline or special motor fuels as exceeds 11.5 cents per gallon, and

(ii) with respect to so much of the rate of tax on diesel fuel or kerosene as exceeds 17.5 cents per gallon,

(E) in the case of fuels described in section 4041(b)(2)(A), 4041(k), or 4081(c), section 4041 or 4081 before October 1, 1999, with respect to a rate equal to 2.5 cents per gallon, or

(F) in the case of fuels described in section 4081(c)(2), such section before October 1, 1999, with respect to a rate equal to 2.8 cents per gallon.

(5) GENERAL REVENUE DEPOSITS OF CERTAIN TAXES ON ALCOHOL MIXTURES.—For purposes of this section, the amounts which would (but for this paragraph) be required to be appropriated under subparagraphs (A) and (E) of paragraph (1) shall be reduced by—

(A) 0.6 cent per gallon in the case of taxes imposed on any mixture at least 10 percent of which is alcohol (as defined in section 4081(c)(3)) if any portion of such alcohol is ethanol, and

[*Caution: Code Sec. 9503(b)(5)(B), below, as amended by Act Sec. 1032(e)(14) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

(B) 0.67 cent per gallon in the case of gasoline, *diesel fuel, or kerosene* used in producing a mixture described in subparagraph (A).

Amendment Notes

Act Sec. 901(a) amended Code Sec. 9503(b)(4) to read as above. Prior to amendment, Code Sec. 9503(b)(4) read as follows:

(4) CERTAIN ADDITIONAL TAXES NOT TRANSFERRED TO HIGHWAY TRUST FUND.—For purposes of paragraphs (1) and (2)—

(A) there shall not be taken into account the taxes imposed by section 4041(d), and

(B) there shall be taken into account the taxes imposed by sections 4041 and 4081 only to the extent attributable to the Highway Trust Fund financing rate.

The above amendment applies to taxes received in the Treasury after September 30, 1997. For a special rule, see Act Sec. 901(e), below.

Act Sec. 901(e) provides:

(e) DELAYED DEPOSITS OF HIGHWAY MOTOR FUEL TAX REVENUES.—Notwithstanding section 6302 of the Internal Revenue Code of 1986, in the case of deposits of taxes imposed by sections 4041 and 4081 (other than subsection (a)(2)(A)(ii)) of the Internal Revenue Code of 1986, the due date for any deposit which would (but for this subsection) be required to be made after July 31, 1998, and before October 1, 1998, shall be October 5, 1998.

Act Sec. 1032(e)(13) amended Code Sec. 9503(b)(1)(E) by striking "and diesel fuel" and inserting ", diesel fuel, and kerosene".

Act Sec. 1032(e)(14) amended Code Sec. 9503(b)(5)(B) by striking "or diesel fuel" and inserting ", diesel fuel, or kerosene".

The above amendments are effective on July 1, 1998.

(c) EXPENDITURES FROM HIGHWAY TRUST FUND.—

* * *

(2) TRANSFERS FROM HIGHWAY TRUST FUND FOR CERTAIN REPAYMENTS AND CREDITS.—

(A) IN GENERAL.—The Secretary shall pay from time to time from the Highway Trust Fund into the general fund of the Treasury amounts equivalent to—

(i) the amounts paid before July 1, 2000, under—

(I) section 6420 (relating to amounts paid in respect of gasoline used on farms),

(II) section 6421 (relating to amounts paid in respect of gasoline used for certain nonhighway purposes or by local transit systems),

(III) section 6424 (relating to amounts paid in respect of lubricating oil used for certain nontaxable purposes), and

(IV) section 6427 (relating to fuels not used for taxable purposes), on the basis of claims filed for periods ending before October 1, 1999, and

(ii) the credits allowed under section 34 (relating to credit for certain uses of gasoline, special fuels, and lubricating oil) with respect to gasoline, special fuels, and lubricating oil used before October 1, 1999.

The amounts payable from the Highway Trust Fund under this subparagraph or paragraph (3) shall be determined *by taking into account only the portion of the taxes which are deposited into the Highway Trust Fund.*

* * *

(4) TRANSFERS FROM THE TRUST FUND FOR MOTORBOAT FUEL TAXES.—

* * *

(D) MOTORBOAT FUEL TAXES.—For purposes of this paragraph, the term "motorboat fuel taxes" means the taxes under section 4041(a)(2) with respect to special motor fuels used as fuel in motorboats and under section 4081 with respect to gasoline used as fuel in motorboats, but only to the extent such taxes are *deposited into the Highway Trust Fund.*

* * *

(5) TRANSFERS FROM THE TRUST FUND FOR SMALL-ENGINE FUEL TAXES.—

* * *

(B) SMALL-ENGINE FUEL TAXES.—For purposes of this paragraph, the term "small-engine fuel taxes" means the taxes under section 4081 with respect to gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment, but only to the extent such taxes are *deposited into the Highway Trust Fund.*

(6) TRANSFERS FROM TRUST FUND OF CERTAIN RECREATIONAL FUEL TAXES, ETC.—

* * *

(D) NONHIGHWAY RECREATIONAL FUEL TAXES.—For purposes of this paragraph, the term "nonhighway recreational fuel taxes" means taxes under section 4041 and 4081 (to the extent *deposited into the Highway Trust Fund*) with respect to—

(i) fuel used in vehicles on recreational trails or back country terrain (including vehicles registered for highway use when used on recreational trails, trail access roads not eligible for funding under title 23, United States Code, or back country terrain), and

(ii) fuel used in campstoves and other non-engine uses in outdoor recreational equipment.

Such term shall not include small-engine fuel taxes (as defined by paragraph (5)) and taxes which are credited or refunded.

* * *

(7) LIMITATION ON EXPENDITURES.—Notwithstanding any other provision of law, in calculating amounts under section 157(a) of title 23, United States Code, and sections 1013(c), 1015(a), and 1015(b) of the Intermodal Surface Transportation Efficiency Act of 1991 (Public Law 102-240; 105 Stat. 1914), deposits in the Highway Trust Fund resulting from the amendments made by the Taxpayer Relief Act of 1997 shall not be taken into account.

* * *

Amendment Notes

Act Sec. 901(c) amended Code Sec. 9503(c) by adding a new paragraph (7) to read as above.

Act Sec. 901(d)(2) amended Code Sec. 9503(c)(2)(A) by striking "by taking into account only the Highway Trust Fund financing rate applicable to any fuel" in the last sentence and inserting "by taking into account only the portion of the taxes which are deposited into the Highway Trust Fund".

Act Sec. 901(d)(3) amended Code Sec. 9503(c)(4)(D), (5)(B), and (6)(D) by striking "attributable to the Highway Trust Fund financing rate" and inserting "deposited into the Highway Trust Fund".

The above amendments apply to taxes received in the Treasury after September 30, 1997.

Act Sec. 1601(f)(2)(A) amended Code Sec. 9503(c)(2)(A)(ii) by striking "(or with respect to qualified diesel-powered highway vehicles purchased before January 1, 1999)" before the period at the end of the sentence.

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for vehicles purchased after August 20, 1996.—CCH.].

(e) ESTABLISHMENT OF MASS TRANSIT ACCOUNT.—

* * *

(2) TRANSFERS TO MASS TRANSIT ACCOUNT.—The Secretary of the Treasury shall transfer to the Mass Transit Account the mass transit portion of the amounts appropriated to the Highway Trust Fund under subsection (b) which are attributable to taxes under sections 4041 and 4081 imposed after March 31, 1983. For purposes of the preceding sentence, the term "mass transit portion" means an amount determined at the rate of *2.85 cents* for each gallon with respect to which tax was imposed under section 4041 or 4081.

* * *

(5) PORTION OF CERTAIN TRANSFERS TO BE MADE FROM ACCOUNT.—

(A) IN GENERAL.—Transfers under paragraphs (2), (3), and (4) of subsection (c) shall be borne by the Highway Account and the Mass Transit Account in proportion to the respective revenues transferred under this section to the Highway Account (after the application of paragraph (2)) and the Mass Transit Account.

* * *

Amendment Notes

Act Sec. 901(b) amended Code Sec. 9503(e)(2) by striking "2 cents" and inserting "2.85 cents".

The above amendment applies to taxes received in the Treasury after September 30, 1997.

Act Sec. 1601(f)(2)(B) amended Code Sec. 9503(e)(5)(A) by striking "; except that" and all that follows and inserting a period. Prior to amendment, Code Sec. 9503(e)(5)(A) read as follows:

(A) IN GENERAL.—Transfers under paragraphs (2), (3), and (4) of subsection (c) shall be borne by the Highway Account and the Mass Transit Account in proportion to the respective revenues transferred under this section to the Highway Account (after the application of paragraph (2)) and the Mass Transit Account; except that any such transfers to the extent attributable to section 6427(g) shall be borne only by the Highway Account.

The above amendment is effective as if included in the provision of the Small Business Job Protection Act of 1996 (P.L. 104-188) to which it relates [effective for vehicles purchased after August 20, 1996.—CCH.].

(f) *[Stricken.]*

* * *

[CCH Explanation at ¶ 1211, 1223 and 1292. Committee Reports at ¶ 10,515, 11,285 and 13,650.]

Amendment Notes

Act Sec. 901(d)(1) amended Code Sec. 9503 by striking subsection (f). Prior to being stricken, Code Sec. 9503(f) read as follows:

(f) DEFINITION OF HIGHWAY TRUST FUND FINANCING RATE.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the Highway Trust Fund financing rate is—

(A) in the case of gasoline and special motor fuels, 11.5 cents per gallon (14 cents per gallon after September 30, 1995), and

(B) in the case of diesel fuel, 17.5 cents per gallon (20 cents per gallon after September 30, 1995).

(2) CERTAIN USES.—

(A) TRAINS.—In the case of fuel used in a train, the Highway Trust Fund financing rate is zero.

(B) CERTAIN BUSES.—In the case of diesel fuel used in a use described in section 6427(b)(1) (after the application of section 6427(b)(3)), the Highway Trust Fund financing rate is 3 cents per gallon.

(C) CERTAIN BOATS.—In the case of diesel fuel used in a boat described in clause (iv) of section 6421(e)(2)(B), the Highway Trust Fund financing rate is zero.

(D) COMPRESSED NATURAL GAS.—In the case of the tax imposed by section 4041(a)(3), the Highway Trust Fund financing rate is zero.

(E) CERTAIN OTHER NONHIGHWAY USES.—In the case of gasoline and special motor fuels used as described in paragraph (4)(D), (5)(B), or (6)(D) of subsection (c), the Highway Trust Fund financing rate is 11.5 cents per gallon; and, in the case of diesel fuel used as described in subsection (c)(6)(D), the Highway Trust Fund financing rate is 17.5 cents per gallon.

(3) ALCOHOL FUELS.—

(A) IN GENERAL.—If the rate of tax on any fuel is determined under section 4041(b)(2)(A), 4041(k), or 4081(c), the Highway Trust Fund financing rate is the excess (if any) of the rate so determined over—

(i) 6.8 cents per gallon after September 30, 1993, and before October 1, 1999,

(ii) 4.3 cents per gallon after September 30, 1999.

In the case of a rate of tax determined under section 4081(c), the preceding sentence shall be applied by increasing the rates specified in clauses (i) and (ii) by 0.1 cent.

(B) FUELS USED TO PRODUCE MIXTURES.—In the case of a rate of tax determined under section 4081(c)(2), subparagraph (A) shall be applied by substituting rates which are 10/9 of the rates otherwise applicable under clauses (i) and (ii) of subparagraph (A).

(C) PARTIALLY EXEMPT METHANOL OR ETHANOL FUEL.—In the case of a rate of tax determined under section 4041(m), the Highway Trust Fund financing rate is the excess (if any) of the rate so determined over—

(i) 5.55 cents per gallon after September 30, 1993, and before October 1, 1995, and

(ii) 4.3 cents per gallon after September 30, 1995.

(4) TERMINATION.—Notwithstanding the preceding provisions of this subsection, the Highway Trust Fund financing rate is zero with respect to taxes received in the Treasury after June 30, 2000.

The above amendment applies to taxes received in the Treasury after September 30, 1997.

[¶ 5757] CODE SEC. 9508. LEAKING UNDERGROUND STORAGE TANK TRUST FUND.

* * *

(b) TRANSFER TO TRUST FUND.—There are hereby appropriated to the Leaking Underground Storage Tank Trust Fund amounts equivalent to—

(1) taxes received in the Treasury under section 4041(d) (relating to additional taxes on motor fuels),

[*Caution: Code Sec. 9508(b)(2), below, as amended by Act Sec. 1032(e)(13) of the Taxpayer Relief Act of 1997, is effective on July 1, 1998.—CCH.*]

(2) taxes received in the Treasury under section 4081 (relating to tax on gasoline, *diesel fuel, and kerosene*) to the extent attributable to the Leaking Underground Storage Tax Trust Fund financing rate under such section,

(3) taxes received in the Treasury under section 4091 (relating to tax on aviation fuel) to the extent attributable to the Leaking Underground Storage Tank Trust Fund financing rate under such section,

(4) taxes received in the Treasury under section 4042 (relating to tax on fuel used in commercial transportation on inland waterways) to the extent attributable to the Leaking Underground Storage Tank Trust Fund financing rate under such section, and

(5) amounts received in the Treasury and collected under section 9003(h)(6) of the Solid Waste Disposal Act.

For purposes of this subsection, there shall not be taken into account the taxes imposed by sections 4041 and 4081 on diesel fuel sold for use or used as fuel in a diesel-powered boat.

* * *

[CCH Explanation at ¶ 1211. Committee Reports at ¶ 11,285.]

Amendment Notes

Act Sec. 1032(e)(13) amended Code Sec. 9508(b)(2) by striking "and diesel fuel" and inserting ", diesel fuel, and kerosene".

The above amendment is effective on July 1, 1998.

[¶ 5759] CODE SEC. 9801. INCREASED PORTABILITY THROUGH LIMITATION ON PREEXISTING CONDITION EXCLUSIONS.

* * *

(c) RULES RELATING TO CREDITING PREVIOUS COVERAGE.—

(1) CREDITABLE COVERAGE DEFINED.—For purposes of this part, the term "creditable coverage" means, with respect to an individual, coverage of the individual under any of the following:

(A) A group health plan.

(B) Health insurance coverage.

(C) Part A or part B of title XVIII of the Social Security Act.

(D) Title XIX of the Social Security Act, other than coverage consisting solely of benefits under section 1928.

(E) Chapter 55 of title 10, United States Code.

(F) A medical care program of the Indian Health Service or of a tribal organization.

(G) A State health benefits risk pool.

(H) A health plan offered under chapter 89 of title 5, United States Code.

(I) A public health plan (as defined in regulations).

(J) A health benefit plan under section 5(e) of the Peace Corps Act (22 U.S.C. 2504(e).

Such term does not include coverage consisting solely of coverage of excepted benefits (as defined in *section 9832(c)*).

* * *

[CCH Explanation at ¶ 865. Committee Reports at ¶ 13,455.]

Amendment Notes

Act Sec. 1531(b)(1)(A) amended Code Sec. 9801(c)(1) by striking "section 9805(c)" and inserting "section 9832(c)".

The above amendment applies with respect to group health plans for plan years beginning on or after January 1, 1998.

[¶ 5761] CODE SEC. 9802. PROHIBITING DISCRIMINATION AGAINST INDIVIDUAL PARTICIPANTS AND BENEFICIARIES BASED ON HEALTH STATUS.

* * *

(c) SPECIAL RULES FOR CHURCH PLANS.—A church plan (as defined in section 414(e)) shall not be treated as failing to meet the requirements of this section solely because such plan requires evidence of good health for coverage of—

(1) both any employee of an employer with 10 or less employees (determined without regard to section 414(e)(3)(C)) and any self-employed individual, or

(2) any individual who enrolls after the first 90 days of initial eligibility under the plan.

This subsection shall apply to a plan for any year only if the plan included the provisions described in the preceding sentence on July 15, 1997, and at all times thereafter before the beginning of such year.

* * *

[CCH Explanation at ¶ 867. Committee Reports at ¶ 13,465.]

Amendment Notes

Act Sec. 1532(a) amended Code Sec. 9802 by adding at the end a new subsection (c) to read as above.

The above amendment is effective as if included in the amendments made by section 401(a) of the Health Insurance Portability and Accountability Act of 1996 (P.L. 104-191) [generally effective for plan years beginning after June 30, 1997.—CCH.].

[¶ 5763] *CODE SEC. 9811. STANDARDS RELATING TO BENEFITS FOR MOTHERS AND NEWBORNS.*

(a) REQUIREMENTS FOR MINIMUM HOSPITAL STAY FOLLOWING BIRTH.—

(1) IN GENERAL.—A group health plan may not—

(A) except as provided in paragraph (2)—

(i) restrict benefits for any hospital length of stay in connection with childbirth for the mother or newborn child, following a normal vaginal delivery, to less than 48 hours, or

(ii) restrict benefits for any hospital length of stay in connection with childbirth for the mother or newborn child, following a caesarean section, to less than 96 hours; or

(B) require that a provider obtain authorization from the plan or the issuer for prescribing any length of stay required under subparagraph (A) (without regard to paragraph (2)).

(2) EXCEPTION.—Paragraph (1)(A) shall not apply in connection with any group health plan in any case in which the decision to discharge the mother or her newborn child prior to the expiration of the minimum length of stay otherwise required under paragraph (1)(A) is made by an attending provider in consultation with the mother.

(b) PROHIBITIONS.—A group health plan may not—

(1) deny to the mother or her newborn child eligibility, or continued eligibility, to enroll or to renew coverage under the terms of the plan, solely for the purpose of avoiding the requirements of this section;

(2) provide monetary payments or rebates to mothers to encourage such mothers to accept less than the minimum protections available under this section;

(3) penalize or otherwise reduce or limit the reimbursement of an attending provider because such provider provided care to an individual participant or beneficiary in accordance with this section;

(4) provide incentives (monetary or otherwise) to an attending provider to induce such provider to provide care to an individual participant or beneficiary in a manner inconsistent with this section; or

(5) subject to subsection (c)(3), restrict benefits for any portion of a period within a hospital length of stay required under subsection (a) in a manner which is less favorable than the benefits provided for any preceding portion of such stay.

(c) RULES OF CONSTRUCTION.—

(1) Nothing in this section shall be construed to require a mother who is a participant or beneficiary—

(A) to give birth in a hospital; or

(B) to stay in the hospital for a fixed period of time following the birth of her child.

(2) This section shall not apply with respect to any group health plan which does not provide benefits for hospital lengths of stay in connection with childbirth for a mother or her newborn child.

(3) Nothing in this section shall be construed as preventing a group health plan from imposing deductibles, coinsurance, or other cost-sharing in relation to benefits for hospital lengths of stay in connection with childbirth for a mother or newborn child under the plan, except that such coinsurance or other cost-sharing for any portion of a period within a hospital length of stay required under subsection (a) may not be greater than such coinsurance or cost-sharing for any preceding portion of such stay.

(d) LEVEL AND TYPE OF REIMBURSEMENTS.—Nothing in this section shall be construed to prevent a group health plan from negotiating the level and type of reimbursement with a provider for care provided in accordance with this section.

(f)[(e)] PREEMPTION; EXCEPTION FOR HEALTH INSURANCE COVERAGE IN CERTAIN STATES.—The requirements of this section shall not apply with respect to health insurance coverage if there is a State law (including a decision, rule, regulation, or other State action having the effect of law) for a State that regulates such coverage that is described in any of the following paragraphs:

(1) Such State law requires such coverage to provide for at least a 48-hour hospital length of stay following a normal vaginal delivery and at least a 96-hour hospital length of stay following a caesarean section.

(2) Such State law requires such coverage to provide for maternity and pediatric care in accordance with guidelines established by the American College of Obstetricians and Gynecologists, the American Academy of Pediatrics, or other established professional medical associations.

(3) Such State law requires, in connection with such coverage for maternity care, that the hospital length of stay for such care is left to the decision of (or required to be made by) the attending provider in consultation with the mother.

[CCH Explanation at ¶ 865. Committee Reports at ¶ 13,455.]

Amendment Notes

Act Sec. 1531(a)(4) amended subtitle K by inserting after Code Sec. 9803 a new subchapter B (Code Secs. 9811-9812) to read as above.

The above amendment applies with respect to group health plans for plan years beginning on or after January 1, 1998.

[¶ 5765] *CODE SEC. 9812. PARITY IN THE APPLICATION OF CERTAIN LIMITS TO MENTAL HEALTH BENEFITS.*

(a) IN GENERAL.—

(1) AGGREGATE LIFETIME LIMITS.—In the case of a group health plan that provides both medical and surgical benefits and mental health benefits—

(A) NO LIFETIME LIMIT.—If the plan does not include an aggregate lifetime limit on substantially all medical and surgical benefits, the plan may not impose any aggregate lifetime limit on mental health benefits.

(B) LIFETIME LIMIT.—If the plan includes an aggregate lifetime limit on substantially all medical and surgical benefits (in this paragraph referred to as the "applicable lifetime limit"), the plan shall either—

(i) apply the applicable lifetime limit both to the medical and surgical benefits to which it otherwise would apply and to mental health benefits and not distinguish in the application of such limit between such medical and surgical benefits and mental health benefits; or

(ii) not include any aggregate lifetime limit on mental health benefits that is less than the applicable lifetime limit.

(C) RULE IN CASE OF DIFFERENT LIMITS.—In the case of a plan that is not described in subparagraph (A) or (B) and that includes no or different aggregate lifetime limits on different categories of medical and surgical benefits, the Secretary shall establish rules under which subparagraph (B) is applied to such plan with respect to mental health benefits by substituting for the applicable lifetime limit an average aggregate lifetime limit that is computed taking into account the weighted average of the aggregate lifetime limits applicable to such categories.

(2) ANNUAL LIMITS.—In the case of a group health plan that provides both medical and surgical benefits and mental health benefits—

(A) NO ANNUAL LIMIT.—If the plan does not include an annual limit on substantially all medical and surgical benefits, the plan may not impose any annual limit on mental health benefits.

(B) ANNUAL LIMIT.—If the plan includes an annual limit on substantially all medical and surgical benefits (in this paragraph referred to as the "applicable annual limit"), the plan shall either—

(i) apply the applicable annual limit both to medical and surgical benefits to which it otherwise would apply and to mental health benefits and not distinguish in the application of such limit between such medical and surgical benefits and mental health benefits; or

(ii) not include any annual limit on mental health benefits that is less than the applicable annual limit.

(C) RULE IN CASE OF DIFFERENT LIMITS.—In the case of a plan that is not described in subparagraph (A) or (B) and that includes no or different annual limits on different categories of medical and surgical benefits, the Secretary shall establish rules under which subparagraph (B) is applied to such plan with respect to mental health benefits by substituting for the applicable annual limit an average annual limit that is computed taking into account the weighted average of the annual limits applicable to such categories.

(b) CONSTRUCTION.—Nothing in this section shall be construed—

(1) as requiring a group health plan to provide any mental health benefits; or

(2) in the case of a group health plan that provides mental health benefits, as affecting the terms and conditions (including cost sharing, limits on numbers of visits or days of coverage, and requirements relating to medical necessity) relating to the amount, duration, or scope of mental health benefits under the plan, except as specifically provided in subsection (a) (in regard to parity in the imposition of aggregate lifetime limits and annual limits for mental health benefits).

(c) EXEMPTIONS.—

(1) SMALL EMPLOYER EXEMPTION.—This section shall not apply to any group health plan for any plan year of a small employer (as defined in section 4980D(d)(2)).

(2) INCREASED COST EXEMPTION.—This section shall not apply with respect to a group health plan if the application of this section to such plan results in an increase in the cost under the plan of at least 1 percent.

(d) SEPARATE APPLICATION TO EACH OPTION OFFERED.—In the case of a group health plan that offers a participant or beneficiary two or more benefit package options under the plan, the requirements of this section shall be applied separately with respect to each such option.

(e) DEFINITIONS.—For purposes of this section:

(1) AGGREGATE LIFETIME LIMIT.—The term "aggregate lifetime limit" means, with respect to benefits under a group health plan, a dollar limitation on the total amount that may be paid with respect to such benefits under the plan with respect to an individual or other coverage unit.

(2) ANNUAL LIMIT.—The term "annual limit" means, with respect to benefits under a group health plan, a dollar limitation on the total amount of benefits that may be paid with respect to such benefits in a 12-month period under the plan with respect to an individual or other coverage unit.

(3) MEDICAL OR SURGICAL BENEFITS.—The term "medical or surgical benefits" means benefits with respect to medical or surgical services, as defined under the terms of the plan, but does not include mental health benefits.

(4) MENTAL HEALTH BENEFITS.—The term "mental health benefits" means benefits with respect to mental health services, as defined under the terms of the plan, but does not include benefits with respect to treatment of substance abuse or chemical dependency.

(f) SUNSET.—This section shall not apply to benefits for services furnished on or after September 30, 2001.

[CCH Explanation at ¶ 865. Committee Reports at ¶ 13,455.]

Amendment Notes

Act Sec. 1531(a)(4) amended subtitle K by inserting after Code Sec. 9811 a new Code Sec. 9812 to read as above.

The above amendment applies with respect to group health plans for plan years beginning on or after January 1, 1998.

[¶ 5767] CODE SEC. *9831.* GENERAL EXCEPTIONS.

* * *

(b) EXCEPTION FOR CERTAIN BENEFITS.—The requirements of this chapter shall not apply to any group health plan in relation to its provision of excepted benefits described in section *9832(c)(1).*

Amendment Notes

Act Sec. 1531(a)(2) amended subtitle K by redesignating Code Secs. 9804, 9805, and 9806 as Code Secs. 9831, 9832, and 9833, respectively.

Act Sec. 1531(b)(1)(B) amended Code Sec. 9831(b) by striking "9805(c)(1)" and inserting "9832(c)(1)".

The above amendments apply with respect to group health plans for plan years beginning on or after January 1, 1998.

(c) EXCEPTION FOR CERTAIN BENEFITS IF CERTAIN CONDITIONS MET.—

(1) LIMITED, EXCEPTED BENEFITS.—The requirements of this chapter shall not apply to any group health plan in relation to its provision of excepted benefits described in section *9832(c)(2)* if the benefits—

(A) are provided under a separate policy, certificate, or contract of insurance; or

(B) are otherwise not an integral part of the plan.

(2) NONCOORDINATED, EXCEPTED BENEFITS.—The requirements of this chapter shall not apply to any group health plan in relation to its provision of excepted benefits described in section *9832(c)(3)* if all of the following conditions are met:

(A) The benefits are provided under a separate policy, certificate, or contract of insurance.

(B) There is no coordination between the provision of such benefits and any exclusion of benefits under any group health plan maintained by the same plan sponsor.

(C) Such benefits are paid with respect to an event without regard to whether benefits are provided with respect to such an event under any group health plan maintained by the same plan sponsor.

(3) SUPPLEMENTAL EXCEPTED BENEFITS.—The requirements of this chapter shall not apply to any group health plan in relation to its provision of excepted benefits described in section *9832(c)(4)* if the benefits are provided under a separate policy, certificate, or contract of insurance.

[CCH Explanation at ¶ 865. Committee Reports at ¶ 13,455.]

Amendment Notes

Act Sec. 1531(b)(1)(C) amended Code Sec. 9831(c)(1) by striking "9805(c)(2)" and inserting "9832(c)(2)".

Act Sec. 1531(b)(1)(D) amended Code Sec. 9831(c)(2) by striking "9805(c)(3)" and inserting "9832(c)(3)".

Act Sec. 1531(b)(1)(E) amended Code Sec. 9831(c)(3) by striking "9805(c)(4)" and inserting "9832(c)(4)".

The above amendments apply with respect to group health plans for plan years beginning on or after January 1, 1998.

[¶ 5769] CODE SEC. *9832.* DEFINITIONS.

* * *

[CCH Explanation at ¶ 865. Committee Reports at ¶ 13,455.]

Amendment Notes

Act Sec. 1531(a)(2) amended subtitle K by redesignating Code Sec. 9805 as Code Sec. 9832.

The above amendment applies with respect to group health plans for plan years beginning on or after January 1, 1998.

[¶ 5771] CODE SEC. *9833.* REGULATIONS.

* * *

[CCH Explanation at ¶ 865. Committee Reports at ¶ 13,455.]

Amendment Notes

Act Sec. 1531(a)(2) amended subtitle K by redesignating Code Sec. 9806 as Code Sec. 9833.

The above amendment applies with respect to group health plans for plan years beginning on or after January 1, 1998.

ACT SECTIONS NOT AMENDING CODE SECTIONS

TAXPAYER RELIEF ACT OF 1997

[¶ 7001] ACT SEC. 1. SHORT TITLE; ETC.

(a) SHORT TITLE.—This Act may be cited as the "Taxpayer Relief Act of 1997".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) SECTION 15 NOT TO APPLY.—No amendment made by this Act shall be treated as a change in a rate of tax for purposes of section 15 of the Internal Revenue Code of 1986.

(d) WAIVER OF ESTIMATED TAX PENALTIES.—No addition to tax shall be made under section 6654 or 6655 of the Internal Revenue Code of 1986 for any period before January 1, 1998, for any payment the due date of which is before January 16, 1998, with respect to any underpayment attributable to such period to the extent such underpayment was created or increased by any provision of this Act.

* * *

TITLE I—CHILD TAX CREDIT

[¶ 7004] ACT SEC. 101. CHILD TAX CREDIT.

* * *

(d) CONFORMING AMENDMENTS.—

(1) Section 1324(b)(2) of title 31, United States Code, is amended by inserting before the period at the end ", or enacted by the Taxpayer Relief Act of 1997".

* * *

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1997.

* * *

TITLE III—SAVINGS AND INVESTMENT INCENTIVES

* * *

Subtitle B—Capital Gains

* * *

[¶ 7005] ACT SEC. 311. MAXIMUM CAPITAL GAINS RATES FOR INDIVIDUALS.

* * *

(c) OTHER CONFORMING AMENDMENTS.—

* * *

(2) The second sentence of section 7518(g)(6)(A), and the second sentence of section 607(h)(6)(A) of the Merchant Marine Act, 1936, are each amended by striking "28 percent" and inserting "20 percent".

* * *

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years ending after May 6, 1997.

* * *

TITLE IX—MISCELLANEOUS PROVISIONS

Subtitle A—Provisions Relating to Excise Taxes

* * *

[¶ 7007] ACT SEC. 909. STUDY OF FEASIBILITY OF MOVING COLLECTION POINT FOR DISTILLED SPIRITS EXCISE TAX.

(a) IN GENERAL.—The Secretary of the Treasury or his delegate shall conduct a study of options for changing the event on which the tax imposed by section 5001 of the Internal Revenue Code of 1986 is determined. One such option which shall be studied is determining such tax on removal from registered wholesale warehouses. In studying each such option, such Secretary shall focus on administrative issues including—

(1) tax compliance,

(2) the number of taxpayers required to pay the tax,

(3) the types of financial responsibility requirements that might be required, and

(4) special requirements regarding segregation of non-tax-paid distilled spirits from other products.

Such study shall review the effects of each such option on the Department of the Treasury (including staffing and other demands on budgetary resources) and the change in the period between the time such tax is currently paid and the time such tax would be paid under each such option.

(b) REPORT.—The report of such study shall be submitted to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives not later than March 31, 1998.

* * *

Subtitle B—Revisions Relating to Disasters

* * *

[¶ 7010] ACT SEC. 915. ABATEMENT OF INTEREST ON UNDERPAYMENTS BY TAXPAYERS IN PRESIDENTIALLY DECLARED DISASTER AREAS.

(a) IN GENERAL.—If the Secretary of the Treasury extends for any period the time for filing income tax returns under section 6081 of the Internal Revenue Code of 1986 and the time for paying income tax with respect to such returns under section 6161 of such Code (and waives any penalties relating to the failure to so file or so pay) for any individual located in a Presidentially declared disaster area, the Secretary shall, notwithstanding section 7508A(b) of such Code, abate for such period the assessment of any interest prescribed under section 6601 of such Code on such income tax.

(b) PRESIDENTIALLY DECLARED DISASTER AREA.—For purposes of subsection (a), the term "Presidentially declared disaster area" means, with respect to any individual, any area which the President has determined during 1997 warrants assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

(c) INDIVIDUAL.—For purposes of this section, the term "individual" shall not include any estate or trust.

(d) EFFECTIVE DATE.—This section shall apply to disasters declared after December 31, 1996.

Subtitle C—Provisions Relating to Employment Taxes

[¶ 7012] ACT SEC. 921. CLARIFICATION OF STANDARD TO BE USED IN DETERMINING EMPLOYMENT TAX STATUS OF SECURITIES BROKERS.

(a) IN GENERAL.—In determining for purposes of the Internal Revenue Code of 1986 whether a registered representative of a securities broker-dealer is an employee (as defined in section 3121(d) of the Internal Revenue Code of 1986), no weight shall be given to instructions from the service recipient which are imposed only in compliance with investor protection standards imposed by the Federal Government, any State government, or a governing body pursuant to a delegation by a Federal or State agency.

(b) EFFECTIVE DATE.—Subsection (a) shall apply to services performed after December 31, 1997.

[¶ 7013] ACT SEC. 922. CLARIFICATION OF EXEMPTION FROM SELF-EMPLOYMENT TAX FOR CERTAIN TERMINATION PAYMENTS RECEIVED BY FORMER INSURANCE SALESMEN.

* * *

(b) SOCIAL SECURITY ACT.—Section 211 of the Social Security Act is amended by adding at the end the following new subsection:

"Codification of Treatment of Certain Termination Payments Received by Former Insurance Salesmen

"(j) Nothing in subsection (a) shall be construed as including in the net earnings from self-employment of an individual any amount received during the taxable year from an insurance company on account of services performed by such individual as an insurance salesman for such company if—

"(1) such amount is received after termination of such individual's agreement to perform such services for such company,

"(2) such individual performs no services for such company after such termination and before the close of such taxable year,

"(3) such individual enters into a covenant not to compete against such company which applies to at least the 1-year period beginning on the date of such termination, and

"(4) the amount of such payment—

"(A) depends primarily on policies sold by or credited to the account of such individual during the last year of such agreement or the extent to which such policies remain in force for some period after such termination, or both, and

"(B) does not depend to any extent on length of service or overall earnings from services performed for such company (without regard to whether eligibility for payment depends on length of service).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to payments after December 31, 1997.

Subtitle D—Provisions Relating to Small Businesses

[¶ 7014] ACT SEC. 931. WAIVER OF PENALTY THROUGH JUNE 30, 1998, ON SMALL BUSINESSES FAILING TO MAKE ELECTRONIC FUND TRANSFERS OF TAXES.

No penalty shall be imposed under the Internal Revenue Code of 1986 solely by reason of a failure by a person to use the electronic fund transfer system established under section 6302(h) of such Code if—

(1) such person is a member of a class of taxpayers first required to use such system on or after July 1, 1997, and

(2) such failure occurs before July 1, 1998.

* * *

[¶ 7015] ACT SEC. 935. MORATORIUM ON CERTAIN REGULATIONS.

No temporary or final regulation with respect to the definition of a limited partner under section 1402(a)(13) of the Internal Revenue Code of 1986 may be issued or made effective before July 1, 1998.

* * *

Subtitle G—Other Provisions

* * *

[¶ 7015A] ACT SEC. 967. ADDITIONAL ADVANCE REFUNDING OF CERTAIN VIRGIN ISLAND BONDS.

Subclause (I) of section 149(d)(3)(A)(i) of the Internal Revenue Code of 1986 shall not apply to the second advance refunding of any issue of the Virgin Islands which was first advance refunded before June 9, 1997, if the debt provisions of the refunding bonds are changed to repeal the priority first lien requirement of the refunded bonds.

[¶ 7016] ACT SEC. 976. COMBINED EMPLOYMENT TAX REPORTING DEMONSTRATION PROJECT.

(a) IN GENERAL.—The Secretary of the Treasury shall provide for a demonstration project to assess the feasibility and desirability of expanding combined Federal and State tax reporting.

(b) DESCRIPTION OF DEMONSTRATION PROJECT.—The demonstration project under subsection (a) shall be—

(1) carried out between the Internal Revenue Service and the State of Montana for a period ending with the date which is 5 years after the date of the enactment of this Act,

(2) limited to the reporting of employment taxes, and

(3) limited to the disclosure of the taxpayer identity (as defined in section 6103(b)(6) of such Code) and the signature of the taxpayer.

* * *

[¶ 7019] ACT SEC. 977. ELECTIVE CARRYBACK OF EXISTING CARRYOVERS OF NATIONAL RAILROAD PASSENGER CORPORATION.

(a) ELECTIVE CARRYBACK.—

(1) IN GENERAL.—If the National Railroad Passenger Corporation (in this section referred to as the "Corporation")—

(A) makes an election under this section for its first taxable year ending after September 30, 1997, and

(B) agrees to the conditions specified in paragraph (2),

then the Corporation shall be treated as having made a payment of the tax imposed by chapter 1 of the Internal Revenue Code of 1986 for such first taxable year and the succeeding taxable year in an amount (for each such taxable year) equal to 50 percent of the amount determined under paragraph (3). Each such payment shall be treated as having been made by the Corporation on the last day prescribed by law (without regard to extensions) for filing its return of tax under chapter 1 of such Code for the taxable year to which such payment relates.

(2) CONDITIONS.—

(A) IN GENERAL.—This section shall only apply to the Corporation if it agrees (in such manner as the Secretary of the Treasury or his delegate may prescribe) to—

(i) except as provided in clause (ii), use any refund of the payment described in paragraph (1) (and any interest thereon) solely to finance qualified expenses of the Corporation, and

(ii) make the payments to non-Amtrak States as described in subsection (c).

(B) REPAYMENT.—

(i) IN GENERAL.—The Corporation shall repay to the United States any amount not used in accordance with this paragraph and any amount remaining unused as of January 1, 2010.

(ii) SPECIAL RULES.—For purposes of clause (i)—

(I) no amount shall be treated as remaining unused as of January 1, 2010, if it is obligated as of such date for a qualified expense, and

(II) the Corporation shall not be treated as failing to meet the requirements of clause (i) by reason of investing any amount for a temporary period.

(3) AMOUNT.—For purposes of paragraph (1)—

(A) IN GENERAL.—The amount determined under this paragraph shall be the lesser of—

(i) 35 percent of the Corporation's existing qualified carryovers, or

(ii) the Corporation's net tax liability for the carryback period.

(B) DOLLAR LIMIT.—Such amount shall not exceed $2,323,000,000.

(b) EXISTING QUALIFIED CARRYOVERS; NET TAX LIABILITY.—For purposes of this section—

(1) EXISTING QUALIFIED CARRYOVERS.—The term "existing qualified carryovers" means the aggregate of the amounts which are net operating loss carryovers under section 172(b) of the Internal Revenue Code of 1986 to the Corporation's first taxable year ending after September 30, 1997.

(2) NET TAX LIABILITY FOR CARRYBACK PERIOD.—

(A) IN GENERAL.—The Corporation's net tax liability for the carryback period is the aggregate of the net tax liability of the Corporation's railroad predecessors for taxable years in the carryback period.

(B) NET TAX LIABILITY.—The term "net tax liability" means, with respect to any taxable year, the amount of the tax imposed by chapter 1 of the Internal Revenue Code of 1986 (or any corresponding provision of prior law) for such taxable year, reduced by the sum of the credits allowable against such tax under such Code (or any corresponding provision of prior law).

(C) CARRYBACK PERIOD.—The term "carryback period" means the period—

(i) which begins with the first taxable year of any railroad predecessor beginning before January 1, 1971, for which there is a net tax liability, and

(ii) which ends with the last taxable year of any railroad predecessor beginning before January 1, 1971.

(3) RAILROAD PREDECESSOR.—

(A) IN GENERAL.—The term "railroad predecessor" means—

(i) any railroad which entered into a contract under section 401 or 404(a) of the Rail Passenger Service Act of 1970 relieving the railroad of its entire responsibility for the provision of intercity rail passenger service, and

(ii) any predecessor thereof.

(B) CONSOLIDATED RETURNS.—If any railroad described in subparagraph (A) was a member of an affiliated group which filed a consolidated return for any taxable year in the carryback period, each member of such group shall be treated as a railroad predecessor for such year.

(c) PAYMENTS TO NON-AMTRAK STATES.—

(1) IN GENERAL.—Within 30 days after receipt of any refund of any payment described in subsection (a)(1), the Corporation shall pay to each non-Amtrak State an amount equal to 1 percent of the amount of such refund.

(2) USE OF PAYMENT.—Each non-Amtrak State shall use the payment described in paragraph (1) (and any interest thereon) solely to finance qualified expenses of the State.

(3) REPAYMENT.—A non-Amtrak State shall pay to the United States—

(A) any portion of the payment received by the State under paragraph (1) (and any interest thereon) which is used for a purpose other than to finance qualified expenses of the State or which remains unused as of January 1, 2010, or

(B) if such State ceases to be a non-Amtrak State, the portion of such payment (and any interest thereon) remaining as of the date of the cessation.

Rules similar to the rules of subsection (a)(2)(B) shall apply for purposes of this paragraph.

(d) TAX CONSEQUENCES.—

(1) REDUCTION IN CARRYOVERS.—If the Corporation elects the application of this section, the Corporation's existing qualified carryovers shall be reduced by an amount equal to the amount determined under subsection (a)(3) divided by 0.35.

(2) REDUCTION IN TAX PAID BY RAILROAD PREDECESSORS.—

(A) IN GENERAL.—The Secretary of the Treasury or his delegate shall appropriately adjust the tax account of each railroad predecessor to reduce the net tax liability of such predecessor for taxable years beginning in the carryback period which is offset by reason of the application of this section.

(B) FIFO ORDERING RULE.—The Secretary shall make the adjustments under subparagraph (A) first for the earliest year in the carryback period and then for each subsequent year in such period.

(C) NO EFFECT ON OTHER TAXPAYERS.—In no event shall any taxpayer other than the Corporation be allowed a refund or credit by reason of this section.

(D) WAIVER OF LIMITATIONS.—If the adjustment under subparagraph (A) is barred by the operation of any law or rule of law, such law or rule of law shall be waived solely for purposes of making such adjustment.

(3) TAX TREATMENT OF EXPENDITURES.—With respect to any payment by the Corporation of qualified expenses described in subsection (e)(1)(A) during any taxable year from the amount of any refund of the payment described in subsection (a)(1)—

(A) no deduction shall be allowed to the Corporation with respect to any amount paid or incurred which is attributable to such amount, and

(B) the basis of any property shall be reduced by the portion of the cost of such property which is attributable to such amount.

(4) PAYMENTS TO A NON-AMTRAK STATE.—No deduction shall be allowed to the Corporation under chapter 1 of the Internal Revenue Code of 1986 for any payment to a non-Amtrak State required under subsection (a)(2)(A)(ii).

(e) DEFINITIONS.—For purposes of this section—

(1) QUALIFIED EXPENSES.—The term "qualified expenses" means expenses incurred for—

(A) in the case of the Corporation—

(i) the acquisition of equipment, rolling stock, and other capital improvements, the upgrading of maintenance facilities, and the maintenance of existing equipment, in intercity passenger rail service, and

(ii) the payment of interest and principal on obligations incurred for such acquisition, upgrading, and maintenance, and

(B) in the case of a non-Amtrak State—

(i) the acquisition of equipment, rolling stock, and other capital improvements, the upgrading of maintenance facilities, and the maintenance of existing equipment, in intercity passenger rail service,

(ii) the acquisition of equipment, rolling stock, and other capital improvements, the upgrading of maintenance facilities, and the maintenance of existing equipment, in intercity bus service,

(iii) the purchase of intercity passenger rail services from the Corporation, and

(iv) the payment of interest and principal on obligations incurred for such acquisition, upgrading, maintenance, and purchase.

In the case of a non-Amtrak State which provides its own intercity passenger rail service on the date of the enactment of this paragraph, subparagraph (B) shall be applied by only taking into account clauses (i) and (iv).

(2) NON-AMTRAK STATE.—The term "non-Amtrak State" means, with respect to any payment, any State which does not receive intercity passenger rail service from the Corporation at any time during the period beginning on the date of the enactment of this Act and ending on the date of the payment.

(f) AUTHORIZING REFORM REQUIRED.—

(1) IN GENERAL.—The Secretary of the Treasury shall not make payment of any refund of any payment described in subsection (a)(1) earlier than the date of the enactment of Federal legislation, other than legislation included in this section, which is enacted after July 29, 1997, and which authorizes reforms of the National Railroad Passenger Corporation.

(2) NO INTEREST.—Notwithstanding any other provision of law, if the payment of any refund is delayed by reason of paragraph (1), no interest shall accrue with respect to such payment prior to the 45th day following the date of the enactment of Federal legislation described in paragraph (1).

(3) ESTIMATE OF REVENUE.—For purposes of estimating revenues under budget reconciliation, the impact of this section on Federal revenues shall be determined without regard to this subsection.

Subtitle H—Extension of Duty-Free Treatment Under Generalized System of Preferences

[¶ 7022] ACT SEC. 981. GENERALIZED SYSTEM OF PREFERENCES.

(a) EXTENSION OF DUTY-FREE TREATMENT UNDER SYSTEM.—Section 505 of the Trade Act of 1974 (19 U.S.C. 2465) is amended by striking "May 31, 1997" and inserting "June 30, 1998".

(b) RETROACTIVE APPLICATION FOR CERTAIN LIQUIDATIONS AND RELIQUIDATIONS.—

(1) IN GENERAL.—Notwithstanding section 514 of the Tariff Act of 1930 or any other provision of law and subject to paragraph (2), the entry—

(A) of any article to which duty-free treatment under title V of the Trade Act of 1974 would have applied if the entry had been made on May 31, 1997, and

(B) that was made after May 31, 1997, and before the date of the enactment of this Act,

shall be liquidated or reliquidated as free of duty, and the Secretary of the Treasury shall refund any duty paid with respect to such entry. As used in this subsection, the term "entry" includes a withdrawal from warehouse for consumption.

(2) REQUESTS.—Liquidation or reliquidation may be made under paragraph (1) with respect to an entry only if a request therefor is filed with the Customs Service, within 180 days after the date of the enactment of this Act, that contains sufficient information to enable the Customs Service—

(A) to locate the entry; or

(B) to reconstruct the entry if it cannot be located.

TITLE X—REVENUES

* * *

Subtitle C—Administrative Provisions

[¶ 7024] ACT SEC. 1021. REPORTING OF CERTAIN PAYMENTS MADE TO ATTORNEYS.

* * *

(b) REPORTING OF ATTORNEYS' FEES PAYABLE TO CORPORATIONS.—The regulations providing an exception under section 6041 of the Internal Revenue Code of 1986 for payments made to corporations shall not apply to payments of attorneys' fees.

(c) EFFECTIVE DATE.—The amendment made by this section shall apply to payments made after December 31, 1997.

* * *

[¶ 7025] ACT SEC. 1026. CONFIDENTIALITY AND DISCLOSURE OF RETURNS AND RETURN INFORMATION.

* * *

(b) CONFORMING AMENDMENTS.—

* * *

(2) Section 552a(a)(8)(B) of title 5, United States Code, is amended by striking "or" at the end of clause (v), by adding "or" at the end of clause (vi), and by adding at the end the following new clause:

"(vii) matches performed incident to a levy described in section 6103(k)(8) of the Internal Revenue Code of 1986;".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to levies issued after the date of the enactment of this Act.

* * *

Subtitle E—Provisions Relating to Tax-Exempt Entities

* * *

[¶ 7028] ACT SEC. 1042. TERMINATION OF CERTAIN EXCEPTIONS FROM RULES RELATING TO EXEMPT ORGANIZATIONS WHICH PROVIDE COMMERCIAL-TYPE INSURANCE.

(a) IN GENERAL.—Subparagraphs (A) and (B) of section 1012(c)(4) of the Tax Reform Act of 1986 shall not apply to any taxable year beginning after December 31, 1997.

(b) SPECIAL RULES.—In the case of an organization to which section 501(m) of the Internal Revenue Code of 1986 applies solely by reason of the amendment made by subsection (a)—

(1) no adjustment shall be made under section 481 (or any other provision) of such Code on account of a change in its method of accounting for its first taxable year beginning after December 31, 1997, and

(2) for purposes of determining gain or loss, the adjusted basis of any asset held on the 1st day of such taxable year shall be treated as equal to its fair market value as of such day.

(c) RESERVE WEAKENING AFTER JUNE 8, 1997.—Any reserve weakening after June 8, 1997, by an organization described in subsection (b) shall be treated as occurring in such organization's 1st taxable year beginning after December 31, 1997.

(d) REGULATIONS.—The Secretary of the Treasury or his delegate may prescribe rules for providing proper adjustments for organizations described in subsection (b) with respect to short taxable years which begin during 1998 by reason of section 843 of the Internal Revenue Code of 1986.

* * *

Subtitle H—Pension Provisions

[¶ 7031] ACT SEC. 1071. PENSION ACCRUED BENEFIT DISTRIBUTABLE WITHOUT CONSENT INCREASED TO $5,000.

* * *

(b) AMENDMENTS TO ERISA.—

(1) IN GENERAL.—Section 203(e)(1) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1053(e)(1)) is amended by striking "$3,500" and inserting "$5,000".

(2) CONFORMING AMENDMENTS.—Sections 204(d)(1) and 205(g)(1) and (2) (29 U.S.C. 1054(d)(1) and 1055(g)(1) and (2)) are each amended by striking "$3,500" and inserting "the dollar limit under section 203(e)(1)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after the date of the enactment of this Act.

* * *

Subtitle I—Other Revenue Provisions

* * *

[¶ 7034] ACT SEC. 1088. TREATMENT OF EXCEPTION FROM INSTALLMENT SALES RULES FOR SALES OF PROPERTY BY A MANUFACTURER TO A DEALER.

(a) IN GENERAL.—Paragraph (2) of section 811(c) of the Tax Reform Act of 1986 is hereby repealed.

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by this section shall apply to taxable years beginning more than 1 year after the date of the enactment of this Act.

(2) COORDINATION WITH SECTION 481.—In the case of any taxpayer required by this section to change its method of accounting for any taxable year—

(A) such changes shall be treated as initiated by the taxpayer,

(B) such changes shall be treated as made with the consent of the Secretary of the Treasury, and

(C) the net amount of the adjustments required to be taken into account under section 481(a) of the Internal Revenue Code of 1986 shall be taken into account ratably over the 4 taxable year period beginning with the first taxable year beginning after the date of the enactment of this Act.

● ● ***Tax Reform Act of 1986 Act Sec. 811(c)(2) before repeal***

ACT SEC. 811. ALLOCATION OF INDEBTEDNESS AS PAYMENT ON INSTALLMENT OBLIGATION.

* * *

(c) EFFECTIVE DATES.—

* * *

(2) EXCEPTION FOR CERTAIN SALES OF PROPERTY BY A MANUFACTURER TO A DEALER.—

(A) IN GENERAL.—The amendments made by this section shall not apply to any installment obligation arising from the disposition of tangible personal property by a manufacturer (or any affiliate) to a dealer if—

(i) the dealer is obligated to pay on such obligation only when the dealer resells (or rents) the property,

(ii) the manufacturer has the right to repurchase the property at a fixed (or ascertainable) price after no later than the 9-month period beginning with the date of the sale, and

(iii) such disposition is in a taxable year with respect to which the requirements of subparagraph (B) are met.

(B) RECEIVABLES MUST BE AT LEAST 50 PERCENT OF TOTAL SALES.—

(i) IN GENERAL.—The requirements of this subparagraph are met with respect to any taxable year if for such taxable year and the preceding taxable

● ● *Tax Reform Act of 1986 Act Sec. 811(c)(2) before repeal*

year the aggregate face amount of installment obligations described in subparagraph (A) is at least 50 percent of the total sales to dealers giving rise to such obligations.

(ii) TAXPAYER MUST FAIL FOR 2 CONSECUTIVE YEARS.—A taxpayer shall be treated as failing to meet the requirements of clause (i) only if the taxpayer fails to meet the 50-percent test for both the taxable year and the preceding taxable year.

(C) TRANSITION RULE.—An obligation issued before the date of the enactment of this Act shall be treated as described in subparagraph (A) if, within 60 days after such date, the taxpayer modifies the terms of such obligation to conform to the requirements of subparagraph (A).

(D) APPLICATION WITH OTHER OBLIGATIONS.—In applying section 453C of the Internal Revenue Code of 1986 to any installment obligations to which the amendments made by this section apply, obligations described in subparagraph (A) shall not be treated as applicable installment obligations (within the meaning of section 453C(e)(1) of such Code).

(E) OTHER REQUIREMENTS.—This paragraph shall apply only if the taxpayer meets the requirements of subparagraphs (A) and (B) for its first taxable year beginning after the date of the enactment of this Act.

* * *

* * *

[¶ 7037] ACT SEC. 1090. EXPANDED SSA RECORDS FOR TAX ENFORCEMENT.

(a) EXPANSION OF COORDINATED ENFORCEMENT EFFORTS OF IRS AND HHS OFFICE OF CHILD SUPPORT ENFORCEMENT.—

(1) STATE REPORTING OF SSN OF CHILD.—Section 454A(e)(4)(D) of the Social Security Act (42 U.S.C. 654a(e)(4)(D)) is amended by striking "the birth date of any child" and inserting "the birth date and, beginning not later than October 1, 1999, the social security number, of any child".

(2) FEDERAL CASE REGISTRY OF CHILD SUPPORT ORDERS.—Section 453(h) of such Act (42 U.S.C. 653(h)) is amended—

(A) in paragraph (2), by adding at the end the following: "Beginning not later than October 1, 1999, the information referred to in paragraph (1) shall include the names and social security numbers of the children of such individuals."; and

(B) by adding at the end the following:

"(3) ADMINISTRATION OF FEDERAL TAX LAWS.—The Secretary of the Treasury shall have access to the information described in paragraph (2) for the purpose of administering those sections of the Internal Revenue Code of 1986 which grant tax benefits based on support or residence of children.".

(3) COORDINATION BETWEEN SECRETARIES.—The Secretary of the Treasury and the Secretary of Health and Human Services shall consult regarding the implementation issues resulting from the amendments made by this subsection, including interim deadlines for States that may be able before October 1, 1999, to provide the data required by such amendments. The Secretaries shall report to Congress on the results of such consultation.

(4) EFFECTIVE DATE.—The amendments made by this subsection shall take effect on October 1, 1998.

(b) REQUIRED SUBMISSION OF SSN'S ON APPLICATIONS.—

(1) IN GENERAL.—Section 205(c)(2) of the Social Security Act (42 U.S.C. 405(c)(2)) is amended—

(A) in subparagraph (B)(ii), by adding at the end the following new sentence: "With respect to an application for a social security account number for an individual who has not attained the age of 18 before such application, such evidence shall include the information described in subparagraph (C)(ii).",

(B) in the second sentence of subparagraph (C)(ii), insert "the Commissioner of Social Security and" after "available to", and

(C) by adding at the end the following new subparagraph:

"(H) The Commissioner of Social Security shall share with the Secretary of the Treasury the information obtained by the Commissioner pursuant to the second sentence of subparagraph (B)(ii) and to subparagraph (C)(ii) for the purpose of administering those sections of the Internal Revenue Code of 1986 which grant tax benefits based on support or residence of children.".

(2) EFFECTIVE DATES.—

(A) The amendment made by paragraph (1)(A) shall apply to applications made after the date which is 180 days after the date of the enactment of this Act.

(B) The amendments made by subparagraphs (B) and (C) of paragraph (1) shall apply to information obtained on, before, or after the date of the enactment of this Act.

* * *

TITLE XI—SIMPLIFICATION AND OTHER FOREIGN-RELATED PROVISIONS

* * *

Subtitle G—Other Simplification Provisions

[¶ 7040] ACT SEC. 1161. TRANSITION RULE FOR CERTAIN TRUSTS.

(a) IN GENERAL.—Paragraph (3) of section 1907(a) of the Small Business Job Protection Act of 1996 is amended by adding at the end the following flush sentence:

"To the extent prescribed in regulations by the Secretary of the Treasury or his delegate, a trust which was in existence on August 20, 1996 (other than a trust treated as owned by the grantor under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code of 1986), and which was treated as a United States person on the day before the date of the enactment of this Act may elect to continue to be treated as a United States person notwithstanding section 7701(a)(30)(E) of such Code.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect as if included in the amendments made by section 1907(a) of the Small Business Job Protection Act of 1996.

● ● ***Small Business Act of 1996 Act Sec. 1907(a)(3) as amended***

ACT SEC. 1907. RESIDENCE OF TRUSTS, ETC.

(a) TREATMENT AS UNITED STATES PERSON.—

* * *

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply—

(A) to taxable years beginning after December 31, 1996, or

(B) at the election of the trustee of a trust, to taxable years ending after the date of the enactment of this Act.

Such an election, once made, shall be irrevocable.

To the extent prescribed in regulations by the Secretary of the Treasury or his delegate, a trust which was in existence on August 20, 1996 (other than a trust treated as owned by the grantor under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code of 1986), and which was treated as a United States person on the day before the date of the enactment of this Act may elect to continue to be treated as a United States person notwithstanding section 7701(a)(30)(E) of such Code.

* * *

* * *

TITLE XII—SIMPLIFICATION PROVISIONS RELATING TO INDIVIDUALS AND BUSINESSES

Subtitle A—Provisions Relating to Individuals

* * *

[¶ 7043] ACT SEC. 1203. TREATMENT OF CERTAIN REIMBURSED EXPENSES OF RURAL MAIL CARRIERS.

* * *

(b) TECHNICAL AMENDMENT.—Section 6008 of the Technical and Miscellaneous Revenue Act of 1988 is hereby repealed.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1997.

● ● ***TAMRA 1988 Act Sec. 6008 before repeal***

ACT SEC. 6008. BUSINESS USE OF AUTOMOBILES BY RURAL MAIL CARRIERS.

(a) GENERAL RULE.—In the case of any employee of the United States Postal Service who performs services involving the collection and delivery of mail on a rural route, such employee shall be permitted to compute the amount allowable as a deduction under chapter 1 of the Internal Revenue Code of 1986 for the use of an automobile in performing such services by using a standard mileage rate for all miles of such use equal to 150 percent of the basic standard rate.

(b) SUBSECTION (a) NOT TO APPLY IF EMPLOYEE CLAIMS DEPRECIATION DEDUCTIONS FOR AUTOMOBILE.—Subsection (a) shall not apply with respect to any automobile if, for any taxable year beginning after December 31, 1987, the taxpayer claimed depreciation deductions for such automobile.

(c) BASIC STANDARD RATE.—For purposes of this section, the term "basic standard rate" means the standard mileage rate which is prescribed by the Secretary of the Treasury or his delegate for computing the amount of the deduction for the business use of an automobile and which—

(1) is in effect at the time of the use referred to in subsection (a),

(2) applies to an automobile which is not fully depreciated, and

(3) applies to the first 15,000 miles (or such other number as the Secretary of the Treasury or his delegate may hereafter prescribe) of business use during the taxable year.

(d) EFFECTIVE DATE.—The provisions of this section shall apply to taxable years beginning after December 31, 1987.

* * *

Subtitle D—Other Provisions

* * *

[¶ 7045] ACT SEC. 1462. CLARIFICATION OF AUTHORITY TO WITHHOLD PUERTO RICO INCOME TAXES FROM SALARIES OF FEDERAL EMPLOYEES.

(a) IN GENERAL.—Subsection (c) of section 5517 of title 5, United States Code, is amended by striking "or territory or possession" and inserting ", territory, possession, or commonwealth".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on January 1, 1998.

* * *

TITLE XV—PENSIONS AND EMPLOYEE BENEFITS

Subtitle A—Simplification

* * *

[¶ 7046] ACT SEC. 1502. MODIFICATION OF PROHIBITION OF ASSIGNMENT OR ALIENATION.

(a) AMENDMENT TO ERISA.—Section 206(d) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1056(d)) is amended by adding at the end the following:

"(4) Paragraph (1) shall not apply to any offset of a participant's benefits provided under an employee pension benefit plan against an amount that the participant is ordered or required to pay to the plan if—

"(A) the order or requirement to pay arises—

"(i) under a judgment of conviction for a crime involving such plan,

"(ii) under a civil judgment (including a consent order or decree) entered by a court in an action brought in connection with a violation (or alleged violation) of part 4 of this subtitle, or

"(iii) pursuant to a settlement agreement between the Secretary and the participant, or a settlement agreement between the Pension Benefit Guaranty Corporation and the participant, in connection with a violation (or alleged violation) of part 4 of this subtitle by a fiduciary or any other person,

"(B) the judgment, order, decree, or settlement agreement expressly provides for the offset of all or part of the amount ordered or required to be paid to the plan against the participant's benefits provided under the plan, and

"(C) in a case in which the survivor annuity requirements of section 205 apply with respect to distributions from the plan to the participant, if the participant has a spouse at the time at which the offset is to be made—

"(i) either—

"(I) such spouse has consented in writing to such offset and such consent is witnessed by a notary public or representative of the plan (or it is established to the satisfaction of a plan representative that such consent may not be obtained by reason of circumstances described in section 205(c)(2)(B)), or

"(II) an election to waive the right of the spouse to a qualified joint and survivor annuity or a qualified preretirement survivor annuity is in effect in accordance with the requirements of section 205(c),

"(ii) such spouse is ordered or required in such judgment, order, decree, or settlement to pay an amount to the plan in connection with a violation of part 4 of this subtitle, or

"(iii) in such judgment, order, decree, or settlement, such spouse retains the right to receive the survivor annuity under a qualified joint and survivor annuity provided pursuant to section 205(a)(1) and under a qualified preretirement survivor annuity provided pursuant to section 205(a)(2), determined in accordance with paragraph (5).

A plan shall not be treated as failing to meet the requirements of section 205 solely by reason of an offset under this paragraph.

"(5)(A) The survivor annuity described in paragraph (4)(C)(iii) shall be determined as if—

"(i) the participant terminated employment on the date of the offset,

"(ii) there was no offset,

"(iii) the plan permitted commencement of benefits only on or after normal retirement age,

"(iv) the plan provided only the minimum-required qualified joint and survivor annuity, and

"(v) the amount of the qualified preretirement survivor annuity under the plan is equal to the amount of the survivor annuity payable under the minimum-required qualified joint and survivor annuity.

"(B) For purposes of this paragraph, the term 'minimum-required qualified joint and survivor annuity' means the qualified joint and survivor annuity which is the actuarial equivalent of the participant's accrued benefit (within the meaning of section 3(23)) and under which the survivor annuity is 50 percent of the amount of the annuity which is payable during the joint lives of the participant and the spouse.".

* * *

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to judgments, orders, and decrees issued, and settlement agreements entered into, on or after the date of the enactment of this Act.

[¶ 7049] ACT SEC. 1503. ELIMINATION OF PAPERWORK BURDENS ON PLANS.

(a) ELIMINATION OF UNNECESSARY FILING REQUIREMENTS.—Section 101(b) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1021(b)) is amended by striking paragraphs (1), (2), and (3) and by redesignating paragraphs (4) and (5) as paragraphs (1) and (2), respectively.

(b) ELIMINATION OF PLAN DESCRIPTION.—

(1) IN GENERAL.—Section 102(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1022(a)) is amended—

(A) by striking paragraph (2), and

(B) by striking "(a)(1)" and inserting "(a)".

(2) CONFORMING AMENDMENTS.—

(A) Section 102(b) of such Act (29 U.S.C. 1022(b)) is amended by striking "The plan description and summary plan description shall contain" and inserting "The summary plan description shall contain".

(B) The heading for section 102 of such Act is amended by striking "PLAN DESCRIPTION AND".

(c) FURNISHING OF REPORTS.—

(1) IN GENERAL.—Section 104(a)(1) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1024(a)(1)) is amended to read as follows:

"SEC. 104. (a)(1) The administrator of any employee benefit plan subject to this part shall file with the Secretary the annual report for a plan year within 210 days after the close of such year (or within such time as may be required by regulations promulgated by the Secretary in order to reduce duplicative filing). The Secretary shall make copies of such annual reports available for inspection in the public document room of the Department of Labor.".

(2) SECRETARY MAY REQUEST DOCUMENTS.—

(A) IN GENERAL.—Section 104(a) of such Act (29 U.S.C. 1024(a)) is amended by adding at the end the following:

"(6) The administrator of any employee benefit plan subject to this part shall furnish to the Secretary, upon request, any documents relating to the employee benefit plan, including but not limited to, the latest summary plan description (including any summaries of plan changes not contained in the summary plan description), and the bargaining agreement, trust agreement, contract, or other instrument under which the plan is established or operated.".

(B) PENALTY.—Section 502(c) of such Act (29 U.S.C. 1132(c)) is amended by redesignating paragraph (6) as paragraph (7) and by inserting after paragraph (5) the following:

"(6) If, within 30 days of a request by the Secretary to a plan administrator for documents under section 104(a)(6), the plan administrator fails to furnish the material requested to the Secretary, the Secretary may assess a civil penalty against the plan administrator of up to $100 a day from the date of such failure (but in no event in excess of $1,000 per request). No penalty shall be imposed under this paragraph for any failure resulting from matters reasonably beyond the control of the plan administrator.".

(d) CONFORMING AMENDMENTS.—

(1) Section 104(b)(1) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1024(b)(1)) is amended by striking "section 102(a)(1)" each place it appears and inserting "section 102(a)".

(2) Section 104(b)(2) of such Act (29 U.S.C. 1024(b)(2)) is amended by striking "the plan description and" and inserting "the latest updated summary plan description and".

(3) Section 104(b)(4) of such Act (29 U.S.C. 1024(b)(4)) is amended by striking "plan description".

(4) Section 106(a) of such Act (29 U.S.C. 1026(a)) is amended by striking "descriptions,".

(5) Section 107 of such Act (29 U.S.C. 1027) is amended by striking "description or".

(6) Section 108(2)(B) of such Act (29 U.S.C. 1028(2)(B)) is amended by striking "plan descriptions, annual reports," and inserting "annual reports".

(7) Section 502(a)(6) of such Act (29 U.S.C. 1132(a)(6)) is amended by striking "or (5)" and inserting "(5), or (6)".

(e) TECHNICAL CORRECTION.—Section 1144(c) of the Social Security Act (42 U.S.C. 1320b-14(c)) is amended by redesignating paragraph (9) as paragraph (8).

* * *

[¶ 7052] ACT SEC. 1506. CLARIFICATION OF CERTAIN RULES RELATING TO EMPLOYEE STOCK OWNERSHIP PLANS OF S CORPORATIONS.

* * *

(b) CERTAIN SHAREHOLDER-EMPLOYEES NOT TREATED AS OWNER-EMPLOYEES.—

* * *

(2) AMENDMENT TO ERISA.—Section 408(d) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1108(d)) is amended to read as follows:

"(d)(1) Section 407(b) and subsections (b), (c), and (e) of this section shall not apply to a transaction in which a plan directly or indirectly—

"(A) lends any part of the corpus or income of the plan to,

"(B) pays any compensation for personal services rendered to the plan to, or

"(C) acquires for the plan any property from, or sells any property to,

any person who is with respect to the plan an owner-employee (as defined in section 401(c)(3) of the Internal Revenue Code of 1986), a member of the family (as defined in section 267(c)(4) of such Code) of any such owner-employee, or any corporation in which any such owner-employee owns, directly or indirectly, 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

"(2)(A) For purposes of paragraph (1), the following shall be treated as owner-employees:

"(i) A shareholder-employee.

"(ii) A participant or beneficiary of an individual retirement plan (as defined in section 7701(a)(37) of the Internal Revenue Code of 1986).

"(iii) An employer or association of employees which establishes such an individual retirement plan under section 408(c) of such Code.

"(B) Paragraph (1)(C) shall not apply to a transaction which consists of a sale of employer securities to an employee stock ownership plan (as defined in section 407(d)(6)) by a shareholder-employee, a member of the family (as defined in section 267(c)(4) of such Code) of any such owner-employee, or a corporation in which such a shareholder-employee owns stock representing a 50 percent or greater interest described in paragraph (1).

"(3) For purposes of paragraph (2), the term 'shareholder-employee' means an employee or officer of an S corporation (as defined in section 1361(a)(1) of such Code) who owns (or is considered as owning within the meaning of section 318(a)(1) of such Code) more than 5 percent of the outstanding stock of the corporation on any day during the taxable year of such corporation."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1997.

* * *

[¶ 7055] ACT SEC. 1508. MODIFICATION OF FUNDING REQUIREMENTS FOR CERTAIN PLANS.

(a) FUNDING RULES FOR CERTAIN PLANS.—Section 769 of the Retirement Protection Act of 1994 is amended by adding at the end the following new subsection:

"(c) TRANSITION RULES FOR CERTAIN PLANS.—

"(1) IN GENERAL.—In the case of a plan that—

"(A) was not required to pay a variable rate premium for the plan year beginning in 1996;

"(B) has not, in any plan year beginning after 1995 and before 2009, merged with another plan (other than a plan sponsored by an employer that was in 1996 within the controlled group of the plan sponsor); and

"(C) is sponsored by a company that is engaged primarily in the interurban or interstate passenger bus service,

the transition rules described in paragraph (2) shall apply for any plan year beginning after 1996 and before 2010.

"(2) TRANSITION RULES.—The transition rules described in this paragraph are as follows:

"(A) For purposes of section 412(l)(9)(A) of the Internal Revenue Code of 1986 and section 302(d)(9)(A) of the Employee Retirement Income Security Act of 1974—

"(i) the funded current liability percentage for any plan year beginning after 1996 and before 2005 shall be treated as not less than 90 percent if for such plan year the funded current liability percentage is at least 85 percent, and

"(ii) the funded current liability percentage for any plan year beginning after 2004 and before 2010 shall be treated as not less than 90 percent if for such plan year the funded current liability percentage satisfies the minimum percentage determined according to the following table:

"In the case of a plan year beginning in:	*The minimum percentage is:*
2005	86 percent
2006	87 percent
2007	88 percent
2008	89 percent
2009 and thereafter	90 percent.

"(B) Sections 412(c)(7)(E)(i)(I) of such Code and 302(c)(7)(E)(i)(I) of such Act shall be applied—

"(i) by substituting '85 percent' for '90 percent' for plan years beginning after 1996 and before 2005, and

"(ii) by substituting the minimum percentage specified in the table contained in subparagraph (A)(ii) for '90 percent' for plan years beginning after 2004 and before 2010.

"(C) In the event the funded current liability percentage of a plan is less than 85 percent for any plan year beginning after 1996 and before 2005, the transition rules under subparagraphs (A) and (B) shall continue to apply to the plan if contributions for such a plan year are made to the plan in an amount equal to the lesser of—

"(i) the amount necessary to result in a funded current liability percentage of 85 percent, or

"(ii) the greater of—

"(I) 2 percent of the plan's current liability as of the beginning of such plan year, or

"(II) the amount necessary to result in a funded current liability percentage of 80 percent as of the end of such plan year.

For the plan year beginning in 2005 and for each of the 3 succeeding plan years, the transition rules under subparagraphs (A) and (B) shall continue to apply to the plan for such plan year only if contributions to the plan for such plan year equal at least the expected increase in current liability due to benefits accruing during such plan year.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to plan years beginning after December 31, 1996.

[¶ 7058] ACT SEC. 1509. CLARIFICATION OF DISQUALIFICATION RULES RELATING TO ACCEPTANCE OF ROLLOVER CONTRIBUTIONS.

The Secretary of the Treasury or his delegate shall clarify that, under the Internal Revenue Service regulations protecting pension plans from disqualification by reason of the receipt of invalid rollover contributions under section 402(c) of the Internal Revenue Code of 1986, in order for the administrator of the plan receiving any such contribution to reasonably conclude that the contribution is a valid rollover contribution it is not necessary for the distributing plan to have a determination letter with respect to its status as a qualified plan under section 401 of such Code.

[¶ 7061] ACT SEC. 1510. NEW TECHNOLOGIES IN RETIREMENT PLANS.

(a) IN GENERAL.—Not later than December 31, 1998, the Secretary of the Treasury and the Secretary of Labor shall each issue guidance which is designed to—

(1) interpret the notice, election, consent, disclosure, and time requirements (and related recordkeeping requirements) under the Internal Revenue Code of 1986 and the Employee Retirement Income Security Act of 1974 relating to retirement plans as applied to the use of new technologies by plan sponsors and administrators while maintaining the protection of the rights of participants and beneficiaries, and

(2) clarify the extent to which writing requirements under the Internal Revenue Code of 1986 relating to retirement plans shall be interpreted to permit paperless transactions.

(b) APPLICABILITY OF FINAL REGULATIONS.—Final regulations applicable to the guidance regarding new technologies described in subsection (a) shall not be effective until the first plan year beginning at least 6 months after the issuance of such final regulations.

Subtitle B—Other Provisions Relating to Pensions and Employee Benefits

[¶ 7064] ACT SEC. 1521. INCREASE IN CURRENT LIABILITY FUNDING LIMIT.

* * *

(b) AMENDMENT TO ERISA.—Section 302(c)(7) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1082(c)(7)) is amended—

(A) by striking "150 percent" in subparagraph (A)(i)(I) and inserting "the applicable percentage", and

(B) by adding at the end the following:

"(F) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A)(i)(I), the applicable percentage shall be determined in accordance with the following table:

"In the case of any plan year beginning in—	*The applicable percentage is—*
1999 or 2000	155
2001 or 2002	160
2003 or 2004	165
2005 and succeeding years	170.".

(c) SPECIAL AMORTIZATION RULE.—

* * *

(2) ERISA AMENDMENT.—Section 302(b)(2) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1082(b)(2)) is amended by striking "and" at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting ", and", and by inserting after subparagraph (D) the following:

"(E) the amount necessary to amortize in equal annual installments (until fully amortized) over a period of 20 years the contributions which would be required to be made under the plan but for the provisions of subsection (c)(7)(A)(i)(I).".

(3) CONFORMING AMENDMENTS.—

* * *

(B) Section 302(c)(7)(D) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1082(c)(7)(D)) is amended by adding "and" at the end of clause (i), by striking ", and" at the end of clause (ii) and inserting a period, and by striking clause (iii).

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to plan years beginning after December 31, 1998.

(2) SPECIAL RULE FOR UNAMORTIZED BALANCES UNDER EXISTING LAW.—The unamortized balance (as of the close of the plan year preceding the plan's first year beginning in 1999) of any amortization base established under section 412(c)(7)(D)(iii) of such Code and section 302(c)(7)(D)(iii) of such Act (as repealed by subsection (c)(3)) for any plan year beginning before 1999 shall be amortized in equal annual installments (until fully amortized) over a period of years equal to the excess of—

(A) 20 years, over

(B) the number of years since the amortization base was established.

* * *

[¶ 7067] ACT SEC. 1524. DIVERSIFICATION OF SECTION 401(k) PLAN INVESTMENTS.

(a) LIMITATIONS ON INVESTMENT IN EMPLOYER SECURITIES AND EMPLOYER REAL PROPERTY BY CASH OR DEFERRED ARRANGEMENTS.—Section 407(b) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1107(b)) is amended by redesignating paragraph (2) as paragraph (3) and by inserting after paragraph (1) the following new paragraph:

"(2)(A) If this paragraph applies to an eligible individual account plan, the portion of such plan which consists of applicable elective deferrals (and earnings allocable thereto) shall be treated as a separate plan—

"(i) which is not an eligible individual account plan, and

"(ii) to which the requirements of this section apply.

"(B)(i) This paragraph shall apply to any eligible individual account plan if any portion of the plan's applicable elective deferrals (or earnings allocable thereto) are required to be invested in qualifying employer securities or qualifying employer real property or both—

"(I) pursuant to the terms of the plan, or

"(II) at the direction of a person other than the participant on whose behalf such elective deferrals are made to the plan (or a beneficiary).

"(ii) This paragraph shall not apply to an individual account plan for a plan year if, on the last day of the preceding plan year, the fair market value of the assets of all individual account plans maintained by the employer equals not more than 10 percent of the fair market value of the assets of all pension plans (other than multiemployer plans) maintained by the employer.

"(iii) This paragraph shall not apply to an individual account plan that is an employee stock ownership plan as defined in section 4975(e)(7) of the Internal Revenue Code of 1986.

"(iv) This paragraph shall not apply to an individual account plan if, pursuant to the terms of the plan, the portion of any employee's applicable elective deferrals which is required to be invested in qualifying employer securities and qualifying employer real property for any year may not exceed 1 percent of the employee's compensation which is taken into account under the plan in determining the maximum amount of the employee's applicable elective deferrals for such year.

"(C) For purposes of this paragraph, the term 'applicable elective deferral' means any elective deferral (as defined in section 402(g)(3)(A) of the Internal Revenue Code of 1986) which is made pursuant to a qualified cash or deferred arrangement as defined in section 401(k) of the Internal Revenue Code of 1986."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to elective deferrals for plan years beginning after December 31, 1998.

* * *

[¶ 7070] ACT SEC. 1529. TREATMENT OF CERTAIN DISABILITY BENEFITS RECEIVED BY FORMER POLICE OFFICERS OR FIREFIGHTERS.

(a) GENERAL RULE.—For purposes of determining whether any amount to which this section applies is excludable from gross income under section 104(a)(1) of the Internal Revenue Code of 1986, the following conditions shall be treated as personal injuries or sickness in the course of employment:

(1) Heart disease.

(2) Hypertension.

(b) AMOUNTS TO WHICH SECTION APPLIES.—This section shall apply to any amount—

(1) which is payable—

(A) to an individual (or to the survivors of an individual) who was a full-time employee of any police department or fire department which is organized and operated by a State, by any political subdivision thereof, or by any agency or instrumentality of a State or political subdivision thereof, and

(B) under a State law (as amended on May 19, 1992) which irrebuttably presumed that heart disease and hypertension are work-related illnesses but only for employees separating from service before July 1, 1992; and

(2) which was received in calendar year 1989, 1990, or 1991.

(c) WAIVER OF STATUTE OF LIMITATIONS.—If, on the date of the enactment of this Act (or at any time within the 1-year period beginning on such date of enactment), credit or refund of any overpayment of tax resulting from the provisions of this section is barred by any law or rule of law (including res judicata), then credit or refund of such overpayment shall, nevertheless, be allowed or made if claim therefore is filed before the date 1 year after such date of enactment.

* * *

Subtitle D—Provisions Relating to Plan Amendments

[¶ 7072] ACT SEC. 1541. PROVISIONS RELATING TO PLAN AMENDMENTS.

(a) IN GENERAL.—If this section applies to any plan or contract amendment—

(1) such plan or contract shall be treated as being operated in accordance with the terms of the plan during the period described in subsection (b)(2)(A), and

(2) such plan shall not fail to meet the requirements of section 411(d)(6) of the Internal Revenue Code of 1986 or section 204(g) of the Employee Retirement Income Security Act of 1974 by reason of such amendment.

(b) AMENDMENTS TO WHICH SECTION APPLIES.—

(1) IN GENERAL.—This section shall apply to any amendment to any plan or annuity contract which is made—

(A) pursuant to any amendment made by this title or subtitle H of title X, and

(B) before the first day of the first plan year beginning on or after January 1, 1999.

In the case of a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986), this paragraph shall be applied by substituting "2001" for "1999".

(2) CONDITIONS.—This section shall not apply to any amendment unless—

(A) during the period—

(i) beginning on the date the legislative amendment described in paragraph (1)(A) takes effect (or in the case of a plan or contract amendment not required by such legislative amendment, the effective date specified by the plan), and

(ii) ending on the date described in paragraph (1)(B) (or, if earlier, the date the plan or contract amendment is adopted),

the plan or contract is operated as if such plan or contract amendment were in effect, and

(B) such plan or contract amendment applies retroactively for such period.

TITLE XVI—TECHNICAL AMENDMENTS RELATED TO SMALL BUSINESS JOB PROTECTION ACT OF 1996 AND OTHER LEGISLATION

[¶ 7073] ACT SEC. 1600. COORDINATION WITH OTHER TITLES.

For purposes of applying the amendments made by any title of this Act other than this title, the provisions of this title shall be treated as having been enacted immediately before the provisions of such other titles.

[¶ 7076] ACT SEC. 1601. AMENDMENTS RELATED TO SMALL BUSINESS JOB PROTECTION ACT OF 1996.

(a) AMENDMENTS RELATED TO SUBTITLE A.—

* * *

(2) AMENDMENT TO SECTION 1116.—Paragraphs (1) and (2)(C) of section 1116(b) of the Small Business Job Protection Act of 1996 shall each be applied as if the reference to chapter 68 were a reference to chapter 61.

● ● ***Small Business Act of 1996 Act Sec. 1116(b)(1), (2)(C) before amendment***

ACT SEC. 1116. CLARIFICATION OF EMPLOYMENT TAX STATUS OF CERTAIN FISHERMEN.

* * *

(b) INFORMATION REPORTING.—

(1) IN GENERAL.—Subpart B of part III of subchapter A of chapter 68 (relating to information concerning transactions with other persons) is amended by inserting after section 6050Q the following new section:

* * *

(2) TECHNICAL AMENDMENTS.—

* * *

(C) The table of sections for subpart B of part III of subchapter A of chapter 68 is amended by inserting after the item relating to 6050Q the following new item:

"Sec. 6050R. Returns relating to certain purchases of fish.".

* * *

* * *

(c) AMENDMENTS RELATED TO SUBTITLE C.—

* * *

(2) EFFECTIVE DATE FOR SECTION 1307.—

(A) Notwithstanding section 1317 of the Small Business Job Protection Act of 1996, the amendments made by subsections (a) and (b) of section 1307 of such Act shall apply to determinations made after December 31, 1996.

(B) In no event shall the 120-day period referred to in section 1377(b)(1)(B) of the Internal Revenue Code of 1986 (as added by such section 1307) expire before the end of the 120-day period beginning on the date of the enactment of this Act.

* * *

(d) AMENDMENTS RELATED TO SUBTITLE D.—

* * *

(4) CLARIFICATION OF SECTION 1450.—

(A) Section 403(b)(11) of the Internal Revenue Code of 1986 shall not apply with respect to a distribution from a contract described in section 1450(b)(1) of such Act to the extent that such distribution is not includible in income by reason of—

(i) in the case of distributions before January 1, 1998, section 403 (b)(8) or (b)(10) of such Code (determined after the application of section 1450(b)(2) of such Act), and

(ii) in the case of distributions on and after such date, such section 403(b)(1).

(B) This paragraph shall apply as if included in section 1450 of the Small Business Job Protection Act of 1996.

(5) AMENDMENT RELATED TO SECTION 1451.—Clause (ii) of section 205(c)(8)(A) of the Employee Retirement Income Security Act of 1974 is amended by striking "Secretary" and inserting "Secretary of the Treasury".

* * *

(f) AMENDMENTS RELATED TO SUBTITLE F.—

* * *

(4) AMENDMENTS RELATED TO SECTION 1609.—

* * *

(E) Paragraph (1) of section 1609(h) of such Act is amended by striking "paragraph (3)(A)(i)" and inserting "paragraph (3)(A)".

(F) Paragraph (4) of section 1609(h) of such Act is amended by inserting before the period "or exclusively for the use described in section 4092(b) of such Code".

● ● ***Small Business Act of 1996 Act Sec. 1609(h)(1) and (4) as amended***

ACT SEC. 1609. EXTENSION OF AIRPORT AND AIRWAY TRUST FUND EXCISE TAXES.

* * *

(h) FLOOR STOCKS TAXES ON AVIATION FUEL.—

(1) IMPOSITION OF TAX.—In the case of aviation fuel on which tax was imposed under section 4091 of the Internal Revenue Code of 1986 before the tax-increase date described in *paragraph (3)(A)* and which is held on such date by any person, there is hereby imposed a floor stocks tax of 17.5 cents per gallon.

* * *

(4) EXCEPTION FOR EXEMPT USES.—The tax imposed by paragraph (1) shall not apply to aviation fuel held by any person on any tax-increase date exclusively for any use for which a credit or refund of the entire tax imposed by section 4091 of such Code is allowable for aviation fuel purchased on or after such tax-increase date for such use *or exclusively for the use described in section 4092(b) of such Code.*

* * *

* * *

(g) AMENDMENTS RELATED TO SUBTITLE G.—

* * *

(2) AMENDMENTS TO SECTIONS 1703 AND 1704.—Sections 1703(n)(8) and 1704(j)(4)(B) of the Small Business Job Protection Act of 1996 shall each be applied as if such sections referred to section 1702 instead of section 1602.

• • *SBA of '96 Act Secs. 1703(n)(8), 1704(j)(4)(B) before amendment*

ACT SEC. 1703. AMENDMENTS RELATED TO REVENUE RECONCILIATION ACT OF 1993.

* * *

(n) CLERICAL AMENDMENTS.—

* * *

(8) Subsection (m) of section 6501 (as redesignated by section 1602) is amended by striking "or 51(j)" and inserting "45B, or 51(j)".

* * *

ACT SEC. 1704. MISCELLANEOUS PROVISIONS.

* * *

(j) AMENDMENTS RELATED TO REVENUE PROVISIONS OF ENERGY POLICY ACT OF 1992.—

* * *

(4)(B) Subsection (m) of Section 6501 (as redesignated by section 1602) is amended by striking "section 40(f)" and inserting "sections 30(d)(4), 40(f)".

* * *

(h) AMENDMENTS RELATED TO SUBTITLE H.—

(1) AMENDMENTS RELATED TO SECTION 1806.—

* * *

(C) Paragraph (2) of section 1806(c) of the Small Business Job Protection Act of 1996 is amended by striking so much of the first sentence as follows subparagraph (B)(ii) and inserting the following:

"then such program (as in effect on August 20, 1996) shall be treated as a qualified State tuition program with respect to contributions (and earnings allocable thereto) pursuant to contracts entered into under such program before the first date on which such program meets such requirements (determined without regard to this paragraph) and the provisions of such program (as so in effect) shall apply in lieu of section 529(b) of the Internal Revenue Code of 1986 with respect to such contributions and earnings.".

• • *Small Business Act of 1996 Act Sec. 1806(c)(2) before amendment*

ACT SEC. 1806. QUALIFIED STATE TUITION PROGRAMS.

* * *

(c) EFFECTIVE DATES.—

* * *

(2) TRANSITION RULE.—If—

(A) a State or agency or instrumentality thereof maintains, on the date of the enactment of this Act, a program under which persons may purchase tuition credits or certificates on behalf of, or make contributions for education expenses of, a designated beneficiary, and

(B) such program meets the requirements of a qualified State tuition program before the later of—

(i) the date which is 1 year after such date of enactment, or

(ii) the first day of the first calendar quarter after the close of the first regular session of the State legislature that begins after such date of enactment,

the amendments made by this section shall apply to contributions (and earnings allocable thereto) made before the date such program meets the requirements of such amendments without regard to whether any requirements of such amendments are met with respect to such contributions and earnings.

● ● *Small Business Act of 1996 Act Sec. 1806(c)(2) before amendment*

For purposes of subparagraph (B)(ii), if a State has a 2-year legislative session, each year of such session shall be deemed to be a separate regular session of the State legislature.

* * *

* * *

(i) AMENDMENTS RELATED TO SUBTITLE I.—

* * *

(4) EFFECTIVE DATE RELATED TO SUBTITLE I.—The Secretary of the Treasury may by regulations or other administrative guidance provide that the amendments made by section 1907(a) of the Small Business Job Protection Act of 1996 shall not apply to a trust with respect to a reasonable period beginning on the date of the enactment of such Act, if—

(A) such trust is in existence on August 20, 1996, and is a United States person for purposes of the Internal Revenue Code of 1986 on such date (determined without regard to such amendments),

(B) no election is in effect under section 1907(a)(3)(B) of such Act with respect to such trust,

(C) before the expiration of such reasonable period, such trust makes the modifications necessary to be treated as a United States person for purposes of such Code (determined with regard to such amendments), and

(D) such trust meets such other conditions as the Secretary may require.

(j) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall take effect as if included in the provisions of the Small Business Job Protection Act of 1996 to which they relate.

* * *

[¶ 7079] ACT SEC. 1602. AMENDMENTS RELATED TO HEALTH INSURANCE PORTABILITY AND ACCOUNTABILITY ACT OF 1996.

* * *

(f) AMENDMENTS RELATED TO SECTION 501.—

* * *

(4) Subsection (c) of section 501 of the Health Insurance Portability and Accountability Act of 1996 is amended by striking paragraph (3).

● ● *Health Insurance Act of 1996 Act Sec. 501(c)(3) before amendment*

ACT SEC. 501. DENIAL OF DEDUCTION FOR INTEREST ON LOANS WITH RESPECT TO COMPANY-OWNED LIFE INSURANCE.

* * *

(c) EFFECTIVE DATES.—

* * *

(3) SPECIAL RULE FOR GRANDFATHERED CONTRACTS.—This section shall not apply to any contract purchased on or before June 20, 1996, except that section 264(d)(2) of the Internal Revenue Code of 1986 shall apply to interest paid or accrued after October 13, 1995.

* * *

(5) Paragraph (2) of section 501(d) of such Act is amended by striking "no additional premiums" and all that follows and inserting the following: "a lapse occurring after October 13, 1995, by reason of no additional premiums being received under the contract.".

● ● *Health Insurance Act of 1996 Act Sec. 501(d)(2) before amendment*

ACT SEC. 501. DENIAL OF DEDUCTION FOR INTEREST ON LOANS WITH RESPECT TO COMPANY-OWNED LIFE INSURANCE.

* * *

(d) SPREAD OF INCOME INCLUSION ON SURRENDER, ETC. OF CONTRACTS.—

* * *

● ● *Health Insurance Act of 1996 Act Sec. 501(d)(2) before amendment*

(2) SPECIAL RULES FOR APPLYING SECTION 264.—A contract shall not be treated as—

(A) failing to meet the requirements of section 264(c)(1) of the Internal Revenue Code of 1986, or

(B) a single premium contract under section 264(b)(1) of such Code,

solely by reason of an occurrence described in subparagraph (A) or (B) of paragraph (1) of this subsection or solely by reason of no additional premiums being received under the contract by reason of a lapse occurring after October 13, 1995.

* * *

* * *

[¶ 7082] ACT SEC. 1604. MISCELLANEOUS PROVISIONS.

* * *

(b) AMENDMENTS RELATED TO URUGUAY ROUND AGREEMENTS ACT.—

* * *

(2) * * *

(B) Subclause (II) of section 302(e)(5)(E)(ii) of the Employee Retirement Income Security Act of 1974 is amended by striking "clause (i)" and inserting "subclause (I)".

(3) Subparagraph (A) of section 767(d)(3) of the Uruguay Round Agreements Act is amended in the last sentence by striking "(except that" and all that follows through "into account)".

(4) The amendments made by this subsection shall take effect as if included in the sections of the Uruguay Round Agreements Act to which they relate.

● ● *Uruguay Round Agreements Act Sec. 767(d)(3)(A) before amendment*

ACT SEC. 767. SINGLE SUM DISTRIBUTIONS.

* * *

(d) EFFECTIVE DATE.—

* * *

(3) SECTION 415.—

(A) EXCEPTION.—A plan that was adopted and in effect before December 8, 1994, shall not be required to apply the amendments made by subsection (b) with respect to benefits accrued before the earlier of—

(i) the later of the date a plan amendment applying the amendments made by subsection (b) is adopted or made effective, or

(ii) the first day of the first limitation year beginning after December 31, 1999.

Determinations under section 415(b)(2)(E) of the Internal Revenue Code of 1986 before such earlier date shall be made with respect to such benefits on the basis of such section as in effect on December 7, 1994 (except that the modification made by 1449(b) of the Small Business Job Protection Act of 1996 shall be taken into account), and the provisions of the plan as in effect on December 7, 1994, but only if such provisions of the plan meet the requirements of such section (as so in effect).

* * *

* * *

(f) AMENDMENTS RELATED TO BALANCED BUDGET ACT OF 1997.—

(1) The Balanced Budget Act of 1997 is amended—

(A) in the table of contents for title IV, in the item relating to section 4921, by striking "children with";

(B) in the heading for section 4921, by striking "CHILDREN WITH"; and

(C) in the section added by section 4921—

(i) in the heading for such section, by striking "CHILDREN WITH"; and

(ii) by amending subsection (a) to read as follows:

"(a) IN GENERAL.—The Secretary, directly or through grants, shall provide for research into the prevention and cure of Type I diabetes.".

(2)(A) Section 11201(g)(2)(B)(iii) of the Balanced Budget Act of 1997 shall apply as if the reference in such section to "December 31, 2003" were a reference to "December 31, 2001".

(B) Notwithstanding section 11104(b)(3) of the Balanced Budget Act of 1997, in carrying out any of the management reform plans under such section, the head of a department of the government of the District of Columbia shall report solely to the District of Columbia Financial Responsibility and Management Assistance Authority.

(3) Section 9302 of the Balanced Budget Act of 1997 is amended by adding at the end the following new subsection:

"(k) COORDINATION WITH TOBACCO INDUSTRY SETTLEMENT AGREEMENT.—The increase in excise taxes collected as a result of the amendments made by subsections (a), (e), and (g) of this section shall be credited against the total payments made by parties pursuant to Federal legislation implementing the tobacco industry settlement agreement of June 20, 1997.

(4) The provisions of, and amendments made by, this subsection shall take effect immediately after the sections referred to in this subsection take effect.

* * *

TITLE XVII—IDENTIFICATION OF LIMITED TAX BENEFITS SUBJECT TO LINE ITEM VETO

[¶ 7085] ACT SEC. 1701. IDENTIFICATION OF LIMITED TAX BENEFITS SUBJECT TO LINE ITEM VETO.

Section 1021(a)(3) of the Congressional Budget and Impoundment Control Act of 1974 shall only apply to—

(1) section 101(c) (relating to high risk pools permitted to cover dependents of high risk individuals);

(2) section 222 (relating to limitation on qualified 501(c)(3) bonds other than hospital bonds);

(3) section 224 (relating to contributions of computer technology and equipment for elementary or secondary school purposes);

(4) section 312(a) (relating to treatment of remainder interests for purposes of provision relating to gain on sale of principal residence);

(5) section 501(b) (relating to indexing of alternative valuation of certain farm, etc., real property);

(6) section 504 (relating to extension of treatment of certain rents under section 2032A to lineal descendants);

(7) section 505 (relating to clarification of judicial review of eligibility for extension of time for payment of estate tax);

(8) section 508 (relating to treatment of land subject to qualified conservation easement);

(9) section 511 (relating to expansion of exception from generation-skipping transfer tax for transfers to individuals with deceased parents);

(10) section 601 (relating to the research tax credit);

(11) section 602 (relating to contributions of stock to private foundations);

(12) section 603 (relating to the work opportunity tax credit);

(13) section 604 (relating to orphan drug tax credit);

(14) section 701 (relating to incentives for revitalization of the District of Columbia) to the extent it amends the Internal Revenue Code of 1986 to create sections 1400 and 1400A (relating to tax-exempt economic development bonds);

(15) section 701 (relating to incentives for revitalization of the District of Columbia) to the extent it amends the Internal Revenue Code of 1986 to create section 1400C (relating to first-time homebuyer credit for District of Columbia);

(16) section 801 (relating to incentives for employing long-term family assistance recipients);

(17) section 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine containing pertussis bacteria, extracted or partial cell bacteria, or specific pertussis antigens;

(18) section 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine against measles;

(19) section 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine against mumps;

(20) section 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine against rubella;

(21) section 905 (relating to operators of multiple retail gasoline outlets treated as wholesale distributors for refund purposes);

(22) section 906 (relating to exemption of electric and other clean-fuel motor vehicles from luxury automobile classification);

(23) section 907(a) (relating to rate of tax on liquefied natural gas determined on basis of BTU equivalency with gasoline);

(24) section 907(b) (relating to rate of tax on methanol from natural gas determined on basis of BTU equivalency with gasoline);

(25) section 908 (relating to modification of tax treatment of hard cider);

(26) section 914 (relating to mortgage financing for residences located in disaster areas);

(27) section 962 (relating to assignment of workmen's compensation liability eligible for exclusion relating to personal injury liability assignments);

(28) section 963 (relating to tax-exempt status for certain State worker's compensation act companies);

(29) section 967 (relating to additional advance refunding of certain Virgin Island bonds);

(30) section 968 (relating to nonrecognition of gain on sale of stock to certain farmers' cooperatives);

(31) section 971 (relating to exemption of the incremental cost of a clean fuel vehicle from the limits on depreciation for vehicles);

(32) section 974 (relating to clarification of treatment of certain receivables purchased by cooperative hospital service organizations);

(33) section 975 (relating to deduction in computing adjusted gross income for expenses in connection with service performed by certain officials) with respect to taxable years beginning before 1991;

(34) section 977 (relating to elective carryback of existing carryovers of National Railroad Passenger Corporation);

(35) section 1005(b)(2)(B) (relating to transition rule for instruments described in a ruling request submitted to the Internal Revenue Service on or before June 8, 1997);

(36) section 1005(b)(2)(C) (relating to transition rule for instruments described on or before June 8, 1997, in a public announcement or in a filing with the Securities and Exchange Commission) as it relates to a public announcement;

(37) section 1005(b)(2)(C) (relating to transition rule for instruments described on or before June 8, 1997, in a public announcement or in a filing with the Securities and Exchange Commission) as it relates to a filing with the Securities and Exchange Commission;

(38) section 1011(d)(2)(B) (relating to transition rule for distributions made pursuant to the terms of a tender offer outstanding on May 3, 1995);

(39) section 1011(d)(3) (relating to transition rule for distributions made pursuant to the terms of a tender offer outstanding on September 13, 1995);

(40) section 1012(d)(3)(B) (relating to transition rule for distributions pursuant to an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 described in a ruling request submitted to the Internal Revenue Service on or before April 16, 1997);

(41) section 1012(d)(3)(C) (relating to transition rule for distributions pursuant to an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 described in a public announcement or filing with the Securities and Exchange Commission) as it relates to a public announcement;

(42) section 1012(d)(3)(C) (relating to transition rule for distributions pursuant to an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 described in a

public announcement or filing with the Securities and Exchange Commission) as it relates to a filing with the Securities and Exchange Commission;

(43) section 1013(d)(2)(B) (relating to transition rule for distributions or acquisitions after June 8, 1997, described in a ruling request submitted to the Internal Revenue Service submitted on or before June 8, 1997);

(44) section 1013(d)(2)(C) (relating to transition rule for distributions or acquisitions after June 8, 1997, described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a public announcement;

(45) section 1013(d)(2)(C) (relating to transition rule for distributions or acquisitions after June 8, 1997, described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a filing with the Securities and Exchange Commission;

(46) section 1014(f)(2)(B) (relating to transition rule for any transaction after June 8, 1997, if such transaction is described in a ruling request submitted to the Internal Revenue Service on or before June 8, 1997);

(47) section 1014(f)(2)(C) (relating to transition rule for any transaction after June 8, 1997, if such transaction is described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a public announcement;

(48) section 1014(f)(2)(C) (relating to transition rule for any transaction after June 8, 1997, if such transaction is described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a filing with the Securities and Exchange Commission;

(49) section 1042(b) (relating to special rules for provision terminating certain exceptions from rules relating to exempt organizations which provide commercial-type insurance);

(50) section 1081(a) (relating to termination of suspense accounts for family corporations required to use accrual method of accounting) as it relates to the repeal of Internal Revenue Code section 447(i)(3);

(51) section 1089(b)(3) (relating to reformations);

(52) section 1089(b)(5)(B)(i) (relating to persons under a mental disability;

(53) section 1171 (relating to treatment of computer software as FSC export property);

(54) section 1175 (relating to exemption for active financing income);

(55) section 1204 (relating to travel expenses of certain Federal employees engaged in criminal investigations);

(56) section 1236 (relating to extension of time for filing a request for administrative adjustment);

(57) section 1243 (relating to special rules for administrative adjustment request with respect to bad debts or worthless securities);

(58) section 1251 (relating to clarification of limitation on maximum number of shareholders);

(59) section 1253 (relating to attribution rules applicable to stock ownership);

(60) section 1256 (relating to modification of earnings and profits rules for determining whether REIT has earnings and profits from non-REIT year);

(61) section 1257 (relating to treatment of foreclosure property);

(62) section 1261 (relating to shared appreciation mortgages);

(63) section 1302 (relating to clarification of waiver of certain rights of recovery);

(64) section 1303 (relating to transitional rule under section 2056A);

(65) section 1304 (relating to treatment for estate tax purposes of short-term obligations held by nonresident aliens);

(66) section 1311 (relating to clarification of treatment of survivor annuities under qualified terminable interest rules);

(67) section 1312 (relating to treatment of qualified domestic trust rules of forms of ownership which are not trusts);

(68) section 1313 (relating to opportunity to correct failures under section 2032A);

(69) section 1414 (relating to fermented material from any brewery may be received at a distilled spirits plant);

(70) section 1417 (relating to use of additional ameliorating material in certain wines);

(71) section 1418 (relating to domestically produced beer may be withdrawn free of tax for use of foreign embassies, legations, etc.);

(72) section 1421 (relating to transfer to brewery of beer imported in bulk without payment of tax);

(73) section 1422 (relating to transfer to bonded wine cellars of wine imported in bulk without payment of tax);

(74) section 1506 (relating to clarification of certain rules relating to employee stock ownership plans of S corporations);

(75) section 1507 (relating to modification of 10-percent tax for nondeductible contributions);

(76) section 1523 (relating to repeal of application of unrelated business income tax to ESOPs);

(77) section 1530 (relating to gratuitous transfers for the benefit of employees);

(78) section 1532 (relating to special rules relating to church plans); and

(79) section 1604(c)(2) (relating to amendment related to Omnibus Budget Reconciliation Act of 1993).

BALANCED BUDGET ACT OF 1997

[¶ 7087] ACT SEC. 1. SHORT TITLE.

This Act may be cited as the "Balanced Budget Act of 1997".

* * *

TITLE IV—MEDICARE, MEDICAID, AND CHILDREN'S HEALTH PROVISIONS

[¶ 7089] ACT SEC. 4000. AMENDMENTS TO SOCIAL SECURITY ACT AND REFERENCES TO OBRA; TABLE OF CONTENTS OF TITLE.

(a) AMENDMENTS TO SOCIAL SECURITY ACT.—Except as otherwise specifically provided, whenever in this title an amendment is expressed in terms of an amendment to or repeal of a section or other provision, the reference shall be considered to be made to that section or other provision of the Social Security Act.

(b) REFERENCES TO OBRA.—In this title, the terms "OBRA-1986", "OBRA-1987", "OBRA-1989", "OBRA-1990", and "OBRA-1993" refer to the Omnibus Budget Reconciliation Act of 1986 (Public Law 99-509), the Omnibus Budget Reconciliation Act of 1987 (Public Law 100-203), the Omnibus Budget Reconciliation Act of 1989 (Public Law 101-239), the Omnibus Budget Reconciliation Act of 1990 (Public Law 101-508), and the Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66), respectively.

* * *

Subtitle A—Medicare+Choice Program

CHAPTER 1—MEDICARE+CHOICE PROGRAM

Subchapter A—Medicare+Choice Program

[¶ 7091] ACT SEC. 4001. ESTABLISHMENT OF MEDICARE+CHOICE PROGRAM.

Title XVIII is amended by redesignating part C as part D and by inserting after part B the following new part:

"PART C—MEDICARE+CHOICE PROGRAM

"ELIGIBILITY, ELECTION, AND ENROLLMENT

"SEC. 1851. (a) CHOICE OF MEDICARE BENEFITS THROUGH MEDICARE+CHOICE PLANS.—

* * *

"(2) TYPES OF MEDICARE+CHOICE PLANS THAT MAY BE AVAILABLE.—A Medicare+Choice plan may be any of the following types of plans of health insurance:

* * *

"(B) COMBINATION OF MSA PLAN AND CONTRIBUTIONS TO MEDICARE+CHOICE MSA.—An MSA plan, as defined in section 1859(b)(3), and a contribution into a Medicare+Choice medical savings account (MSA).

* * *

"(3) MEDICARE+CHOICE ELIGIBLE INDIVIDUAL.—

"(A) IN GENERAL.—In this title, subject to subparagraph (B), the term 'Medicare+Choice eligible individual' means an individual who is entitled to benefits under part A and enrolled under part B.

"(B) SPECIAL RULE FOR END-STAGE RENAL DISEASE.—Such term shall not include an individual medically determined to have end-stage renal disease, except that an individual who develops end-stage renal disease while enrolled in a Medicare+Choice plan may continue to be enrolled in that plan.

"(b) SPECIAL RULES.—

* * *

"(4) COVERAGE UNDER MSA PLANS ON A DEMONSTRATION BASIS.—

"(A) IN GENERAL.—An individual is not eligible to enroll in an MSA plan under this part—

"(i) on or after January 1, 2003, unless the enrollment is the continuation of such an enrollment in effect as of such date; or

"(ii) as of any date if the number of such individuals so enrolled as of such date has reached 390,000.

Under rules established by the Secretary, an individual is not eligible to enroll (or continue enrollment) in an MSA plan for a year unless the individual provides assurances satisfactory to the Secretary that the individual will reside in the United States for at least 183 days during the year.

"(B) EVALUATION.—The Secretary shall regularly evaluate the impact of permitting enrollment in MSA plans under this part on selection (including adverse selection), use of preventive care, access to care, and the financial status of the Trust Funds under this title.

"(C) REPORTS.—The Secretary shall submit to Congress periodic reports on the numbers of individuals enrolled in such plans and on the evaluation being conducted under subparagraph (B). The Secretary shall submit such a report, by not later than March 1, 2002, on whether the time limitation under subparagraph (A)(i) should be extended or removed and whether to change the numerical limitation under subparagraph (A)(ii).

* * *

"PAYMENTS TO MEDICARE+CHOICE ORGANIZATIONS

"SEC. 1853. * * *

* * *

"(e) SPECIAL RULES FOR INDIVIDUALS ELECTING MSA PLANS.—

* * *

"(2) ESTABLISHMENT AND DESIGNATION OF MEDICARE+CHOICE MEDICAL SAVINGS ACCOUNT AS REQUIREMENT FOR PAYMENT OF CONTRIBUTION.—In the case of an individual who has elected coverage under an MSA plan, no payment shall be made under paragraph (1) on behalf of an individual for a month unless the individual—

"(A) has established before the beginning of the month (or by such other deadline as the Secretary may specify) a Medicare+Choice MSA (as defined in section 138(b)(2) of the Internal Revenue Code of 1986), and

"(B) if the individual has established more than one such Medicare+Choice MSA, has designated one of such accounts as the individual's Medicare+Choice MSA for purposes of this part.

Under rules under this section, such an individual may change the designation of such account under subparagraph (B) for purposes of this part.

"(3) LUMP-SUM DEPOSIT OF MEDICAL SAVINGS ACCOUNT CONTRIBUTION.—In the case of an individual electing an MSA plan effective beginning with a month in a year, the amount of the contribution to the Medicare+Choice MSA on behalf of the individual for that month and all successive months in the year shall be deposited during that first month. In the case of a termination

of such an election as of a month before the end of a year, the Secretary shall provide for a procedure for the recovery of deposits attributable to the remaining months in the year.

* * *

"DEFINITIONS; MISCELLANEOUS PROVISIONS

"SEC. 1859. * * *

* * *

"(b) DEFINITIONS RELATING TO MEDICARE+CHOICE PLANS.—

* * *

"(3) MSA PLAN.—

"(A) IN GENERAL.—The term 'MSA plan' means a Medicare+Choice plan that—

"(i) provides reimbursement for at least the items and services described in section 1852(a)(1) in a year but only after the enrollee incurs countable expenses (as specified under the plan) equal to the amount of an annual deductible (described in subparagraph (B));

"(ii) counts as such expenses (for purposes of such deductible) at least all amounts that would have been payable under parts A and B, and that would have been payable by the enrollee as deductibles, coinsurance, or copayments, if the enrollee had elected to receive benefits through the provisions of such parts; and

"(iii) provides, after such deductible is met for a year and for all subsequent expenses for items and services referred to in clause (i) in the year, for a level of reimbursement that is not less than—

"(I) 100 percent of such expenses, or

"(II) 100 percent of the amounts that would have been paid (without regard to any deductibles or coinsurance) under parts A and B with respect to such expenses, whichever is less.

"(B) Deductible.—The amount of annual deductible under an MSA plan—

"(i) for contract year 1999 shall be not more than $6,000; and

"(ii) for a subsequent contract year shall be not more than the maximum amount of such deductible for the previous contract year under this subparagraph increased by the national per capita Medicare+Choice growth percentage under section 1853(c)(6) for the year.

If the amount of the deductible under clause (ii) is not a multiple of $50, the amount shall be rounded to the nearest multiple of $50.

* * *

TITLE V—WELFARE AND RELATED PROVISIONS

* * *

Subtitle F—Welfare Reform Technical Corrections

CHAPTER 1—BLOCK GRANTS FOR TEMPORARY ASSISTANCE TO NEEDY FAMILIES

* * *

[¶ 8001] ACT SEC. 5514. OTHER CONFORMING AMENDMENTS.

(a) ELIMINATION OF AMENDMENTS INCLUDED INADVERTENTLY.—Section 110(l) of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (Public Law 104-193; 110 Stat. 2173) is amended—

(1) by striking paragraphs (1), (4), (5), and (7);

(2) by redesignating paragraphs (2), (3), (6), and (8) as paragraphs (1), (2), (3), and (4), respectively; and

(3) by adding "and" at the end of paragraph (3), as so redesignated.

● ● *Welfare Reform Act Act Sec. 110(l)(1)-(8) before amendment*

ACT SEC. 110. CONFORMING AMENDMENTS TO OTHER LAWS.

* * *

(l) The Internal Revenue Code of 1986 (26 U.S.C. 1 et seq.) is amended—

(1) in section 51(d)(9) (26 U.S.C. 51(d)(9)), by striking all that follows "agency as" and inserting "being eligible for financial assistance under part A of title IV of the Social Security Act and as having continually received such financial assistance during the 90-day period which immediately precedes the date on which such individual is hired by the employer.";

(2) in section 3304(a)(16) (26 U.S.C. 3304(a)(16)), by striking "eligibility for aid or services," and all that follows through "children approved" and inserting "eligibility for assistance, or the amount of such assistance, under a State program funded";

(3) in section 6103(l)(7)(D)(i) (26 U.S.C. 6103(l)(7)(D)(i)), by striking "aid to families with dependent children provided under a State plan approved" and inserting "a State program funded";

(4) in section 6103(l)(10) (26 U.S.C. 6103(l)(10))—

(A) by striking "(c) or (d)" each place it appears and inserting "(c), (d), or (e)"; and

(B) by adding at the end of subparagraph (B) the following new sentence: "Any return information disclosed with respect to section 6402(e) shall only be disclosed to officers and employees of the State agency requesting such information.";

(5) in section 6103(p)(4) (26 U.S.C. 6103(p)(4)), in the matter preceding subparagraph (A)—

(A) by striking "(5), (10)" and inserting "(5)"; and

(B) by striking "(9), or (12)" and inserting "(9). (10), or (12)";

(6) in section 6334(a)(11)(A) (26 U.S.C. 6334(a)(11)(A)), by striking "(relating to aid to families with dependent children)";

(7) in section 6402 (26 U.S.C. 6402)—

(A) in subsection (a), by striking "(c) and (d)" and inserting "(c), (d), and (e)";

(B) by redesignating subsections (e) through (i) as subsections (f) through (j), respectively; and

(C) by inserting after subsection (d) the following:

"(e) COLLECTION OF OVERPAYMENTS UNDER TITLE IV-A OF THE SOCIAL SECURITY ACT.—The amount of any overpayment to be refunded to the person making the overpayment shall be reduced (after reductions pursuant to subsections (c) and (d), but before a credit against future liability for an internal revenue tax) in accordance with section 405(e) of the Social Security Act (concerning recovery of overpayments to individuals under State plans approved under part A of the title IV of such Act)."; and

(8) in section 7523(b)(3)(C) (26 U.S.C. 7523(b)(3)(C)), by striking "aid to families with dependent children" and inserting "assistance under a State program funded under part A of title IV of the Social Security Act".

* * *

* * *

[¶ 8005] ACT SEC. 5518. EFFECTIVE DATES.

* * *

(c) AMENDMENTS TO OTHER AMENDATORY PROVISIONS.—The amendments made by section 5514(a) of this Act shall take effect as if the amendments had been included in section 110 of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 at the time such section 110 became law.

* * *

TITLE IX—ASSET SALES, USER FEES, AND MISCELLANEOUS PROVISIONS

* * *

Subtitle C—Miscellaneous Provisions

* * *

[¶ 8010] ACT SEC. 9304. IDENTIFICATION OF LIMITED TAX BENEFITS SUBJECT TO LINE ITEM VETO.

Section 1021(a)(3) of the Congressional Budget Act of 1974 shall only apply to 3306(c)(21) of the Internal Revenue Code of 1986 (as added by section 5406 of this Act).

* * *

TITLE XI—DISTRICT OF COLUMBIA REVITALIZATION

* * *

Subtitle A—District of Columbia Retirement Funds

* * *

CHAPTER 3—DETERMINATIONS AND REVIEW OF ELIGIBILITY AND PAYMENTS; INFORMATION SHARING

* * *

[¶ 8015] ACT SEC. 11024. FEDERAL INFORMATION SHARING FOR VERIFICATION OF BENEFIT DETERMINATIONS.

(a) IN GENERAL.—Except with respect to taxpayer returns and return information subject to section 6103 of the Internal Revenue Code of 1986, the Secretary may—

(1) secure directly from any department or agency of the United States information necessary to enable the Secretary to verify or confirm benefit determinations under this subtitle; and

(2) by regulation authorize the Trustee to review such information for purposes of administering this subtitle and the contract.

* * *

(c) CONFIDENTIALITY.—The Secretary may issue regulations governing the confidentiality of the information obtained pursuant to subsection (a) and the provisions of law amended by subsection (b).

* * *

CHAPTER 4—DISTRICT OF COLUMBIA FEDERAL PENSION LIABILITY TRUST FUND

* * *

Subtitle H—Miscellaneous Provisions

* * *

CHAPTER 3—EFFECTIVE DATE; GENERAL PROVISIONS

* * *

[¶ 8025] ACT SEC. 11721. EFFECTIVE DATE.

Except as otherwise provided in this title, the provisions of this title shall take effect on the later of October 1, 1997, or the day the District of Columbia Financial Responsibility and Management Assistance Authority certifies that the financial plan and budget for the District government for fiscal year 1998 meet the requirements of section 201(c)(1) of the District of Columbia Financial Responsibility and Management Assistance Act of 1995, as amended by this title.

* * *

Committee Reports
Taxpayer Relief Act
¶ 10,001

Reproduced below are the pertinent texts of the controlling Committee Reports that explain the changes enacted by the Taxpayer Relief Act of 1997 (P.L. 105-34). The material herein is the official wording of the relevant House, Senate and Conference Reports, arranged in Act Section order. Headings have been added for convenience in locating the relevant Committee Reports. Any omission of text is indicated by asterisks (*).

References to the official reports are to the following:

- House Ways and Means Committee Report (H.R. 2014) as released on June 18, 1997, issued as CCH Special 4, STANDARD FEDERAL TAX REPORTS No. 27 (Extra Issue), June 24, 1997, referred to as **House Committee Report**.
- Senate Finance Committee Report (S. 949), as released on June 20, 1997, issued as CCH Special 5, STANDARD FEDERAL TAX REPORTS No. 27 (Second Extra Issue), June 25, 1997, referred to as **Senate Committee Report**.
- Taxpayer Relief Bill of 1997 Conference Report and Statement of the Managers (H.R. 2014), as released on July 31, 1997, issued as a CCH Special, STANDARD FEDERAL TAX REPORTS, August 4, 1997, referred to as **Conference Committee Report**.
- Correcting Errors in Enrollment of H.R. 2014, H. Con. Res. 138, referred to as **Enrollment Proceedings—Congressional Record**.

[¶ 10,110] Act Sec. 1(d). Law at ¶ 7001. CCH Explanation at ¶ 1105.

Other Tax Provision

Conference Committee Report

[*Estimated tax penalties*]

* * * In addition, no estimated tax penalties will be imposed under section 6654 or 6655 for any period before January 1, 1998, for any payment the due date of which is before January 16, 1998, with respect to an underpayment to the extent the underpayment is created or increased by a provision of the Act.

[*Effective date.*—This provision is effective on the date of enactment.—CCH.]

[¶ 10,115] Act Sec. 101(a), (b), (d) and (e). Law at ¶ 5005, 5015, 5623 and 7004. CCH Explanation at ¶ 119.

Child and Dependent Care Tax Credits—Health Care for Children

House Committee Report (Code and Related Non-Code Provisions)

[*Child tax credit*]

Child tax credit for children under age 17.—The bill allows taxpayers a maximum nonrefundable tax credit of $500 ($400 for taxable year 1998) for each qualifying child under the age of 17. A qualifying child is defined as an individual for whom the taxpayer can claim a dependency exemption and who is a son or daughter of the taxpayer (or a descendent of either), a stepson or stepdaughter of the taxpayer or an eligible foster child of the taxpayer. The credit amount is not indexed for inflation.

For taxpayers with modified AGI in excess of certain thresholds, the sum of the otherwise allowable child credit and the otherwise allowable dependent care credit is phased out. Specifically, the sum of the otherwise allowable child credit and then the otherwise allowable dependent care credit is reduced by $25 for each $1,000 of modified AGI (or fraction thereof) in excess of the threshold ("the modified AGI phase-out"). For these purposes modified AGI is computed by increasing the taxpayer's AGI by the amount otherwise excluded from gross income under Code sections 911, 931, or 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Marian Islands; and residents of

Puerto Rico, respectively). The reduction is applied first to the child credit and then to the dependent care credit. For married taxpayers filing joint returns, the threshold is $110,000. For taxpayers filing single or head of household returns, the threshold is $75,000. For married taxpayers filing separate returns, the threshold is $55,000. These thresholds are not indexed for inflation.

* * * The maximum amount of the child credit for each taxable year * * * could not exceed an amount equal to the excess of: (1) the taxpayer's regular income tax liability (net of applicable credits) over (2) the sum of the taxpayer's tentative minimum tax liability (determined without regard to the alternative minimum foreign tax credit) and the earned income credit allowed.

Effective date.—Generally, the child tax credit is effective for taxable years beginning after December 31, 1997. * * *

Senate Committee Report

Child tax credit for children under age 17.—The bill allows taxpayers a maximum nonrefundable tax credit of $500 (pro rata amount of $250 in 1997 for children under the age of 13) for each qualifying child under the age of 17. For taxable years beginning after December 31, 2002, the credit is allowed for each qualifying child under the age of 18. A qualifying child is defined as an individual for whom the taxpayer can claim a dependency exemption and who is a son or daughter of the taxpayer (or a descendent of either), a stepson or stepdaughter of the taxpayer or an eligible foster child of the taxpayer. The credit amount is not indexed for inflation.

* * *

For taxpayers with AGI in excess of certain thresholds, the otherwise allowable child credit is phased out. Specifically, the otherwise allowable child credit is reduced by $25 for each $1,000 of modified AGI (or fraction thereof) in excess of the threshold ("the modified AGI phase-out"). For these purposes modified AGI is computed by increasing the taxpayer's AGI by the amount otherwise excluded from gross income under Code sections 911, 931, or 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands; and residents of Puerto Rico, respectively). For married taxpayers filing joint returns, the threshold is $110,000. For taxpayers filing single or head of household returns, the threshold is $75,000. For married taxpayers filing separate returns, the threshold is $55,000. These thresholds are not indexed for inflation.

The maximum amount of the child credit for each taxable year can not exceed an amount equal to the excess of: (1) the taxpayer's regular income tax liability (net of applicable credits) over (2) the sum of the taxpayer's tentative minimum tax liability (determined without regard to the alternative minimum foreign tax credit) and one-half of the earned income credit allowed.

Effective Date.—The child tax credit is effective July 1, 1997, for taxable years beginning after December 31, 1996.

Conference Committee Report

Size of credit.—The conference agreement provides a $500 ($400 for taxable year 1998) credit for each qualifying child under the age of 17.

Qualifying child.—The conference agreement follows the House bill and the Senate amendment. The conference agreement includes a requirement that the taxpayer include the name and taxpayer identification number (TIN) for each qualifying child. The conference agreement also extends the math and clerical error rule to the child tax credit.

* * *

Phaseout.—The conference agreement follows the House bill and the Senate amendment with one modification. The modification is to increase the phaseout rate to $50 for each $1,000 of modified AGI (or fraction thereof) in excess of the threshold. The threshold amounts are unchanged from both the House bill and the Senate amendment.

Maximum allowable child credit.—In general, in the case of a taxpayer with qualifying children, the amount of the child credit equals $500 times the number of qualifying children.

In the case of a taxpayer with one or two qualifying children, a portion of the child credit may be treated as a supplemental child credit amount. This amount equals the excess of (1) $500 times the number of qualifying children up to the excess of the taxpayer's income tax liability (net of applicable credits other than the earned income credit) over the taxpayer's tentative minimum tax liability (determined without regard to the alternative minimum foreign tax credit) over (2) the sum of the taxpayer's regular income tax liability (net of applicable credits other than the earned income credit) and the employee share of FICA (and one-half of the taxpayer's SECA tax liability, if applicable) reduced by any earned income credit amount. In no case will the total amount of the allowable child credit exceed the amount that would result from its calculation as a nonrefundable personal credit.

In the case of a taxpayer with three or more qualifying children, the maximum amount of the child credit for each taxable year cannot exceed the greater of: (1) the excess of the taxpayer's regular tax liability (net of applicable credits other than the earned income credit) over the taxpayer's tentative minimum tax liability (determined without regard to the alternative minimum foreign tax credit), or (2) an amount equal to the excess of the sum of the taxpayer's regular income tax liability (net of applicable credits other than the earned income credit) and the employee share of FICA (and one-half of the taxpayer's SECA tax liability, if applicable) reduced by the earned income credit. To the extent that the amount determined under (1) is greater than the amount determined under (2), the difference is treated as a supplemental child credit amount.

The conferees anticipate that the Secretary of the Treasury will determine whether a simplified method of calculating the child credit, consistent with the formula described above, can be achieved.

Refundable child credit amount.—In the case of a taxpayer with three or more qualifying children, if the amount of the allowable child credit as computed under the computation described immediately above exceeds the taxpayer's regular tax liability before the computation, then the excess is a refundable tax credit.

* * *

Effective date.—Generally, the child tax credit is effective for taxable years beginning after December 31, 1997.

[¶ 10,125] Act Sec. 101(c) and (e). Law at ¶ 5171 and 7004. CCH Explanation at ¶ 603.

Child and Dependent Care Tax Credits—Health Care for Children

House Committee Report (Code and Related Non-Code Provisions)

[*High-risk individuals: State-sponsored health care organizations*]

Expand definition of high-risk individuals with respect to tax-exempt state-sponsored organizations providing health coverage.—The provision expands the definition of high-risk individuals to include a child of an individual who meets the present-law definition of a high-risk individual, subject to certain requirements. The requirements are: (1) the taxpayer is allowed a deduction for a personal exemption for the child for the taxable year; (2) the child has not attained the age of 17 as of the close of the calendar year in which the taxable year of the taxpayer begins; and (3) the child is a son or daughter or the taxpayer (or a dependent of either), a stepson or stepdaughter of the taxpayer, or an eligible foster child of the taxpayer.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

Conference Agreement.—The conference agreement follows the House bill, with a modification to further expand the definition of high-risk individuals to include the spouse of an individual who meets the present-law definition of a high-risk individual.

[¶ 10,135] Act Sec. 201. Law at ¶ 5009, 5057, 5611, 5623 and 5711. CCH Explanation at ¶ 139.

Education Tax Incentives—Education Expenses

House Committee Report

[*HOPE credit: Higher education tuition expenses*]

HOPE credit for higher education tuition expenses.—

In general.—Individual taxpayers are allowed to claim a non-refundable HOPE credit against Federal income taxes up to $1,500 per student per year for 50 percent of qualified tuition and related expenses (but not room and board expenses) paid for the first two years of the student's post-secondary education in a degree or certificate program. The qualified tuition and related expenses must be incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent. The HOPE credit is available with respect to an individual student for two taxable years, provided that the student has not completed the first two years of post-secondary education. Beginning in 1998, the maximum credit amount of $1,500 will be indexed for inflation, rounded down to the closest multiple of $50.[5]

The HOPE credit amount that a taxpayer may otherwise claim is phased out ratably for taxpay-

[5] The HOPE credit may not be used to reduce any alternative minimum tax (AMT) liability owed by the taxpayer.

ers with modified AGI between $40,000 and $50,000 ($80,000 and $100,000 for joint returns). Modified AGI includes amounts otherwise excluded with respect to income earned abroad (or income from Puerto Rico or U.S. possessions). Beginning in 2001, the income phase-out ranges will be indexed for inflation, rounded down to the closest multiple of $5,000.

The HOPE credit is available in the taxable year the expenses are paid, subject to the requirement that the education commence or continue during that year or during the first three months of the next year. Qualified tuition expenses paid with the proceeds of a loan generally are eligible for the HOPE credit (rather than repayment of the loan itself).[6]

Dependent students.—A taxpayer may claim the HOPE credit with respect to an eligible student who is not the taxpayer or the taxpayer's spouse (e.g., in cases where the student is the taxpayer's child) only if the taxpayer claims the student as a dependent for the taxable year for which the credit is claimed. If a student is claimed as a dependent by the parent or other taxpayer, the eligible student him- or herself is *not* entitled to claim a HOPE credit for that taxable year on the student's own tax return. If a parent (or other taxpayer) claims a student as a dependent, any qualified tuition and related expenses paid by the student are treated as paid by the parent (or other taxpayer) for purposes of the provision.

Election of HOPE credit or proposed deduction for qualified higher education expenses.—For each taxable year, a taxpayer may elect with respect to an eligible student *either* the HOPE credit *or* the proposed deduction for qualified higher education expenses (described below). Thus, for example, if a parent claims a child as a dependent for a taxable year, then all qualified tuition expenses paid by *both* the parent and child are deemed paid by the parent, and the parent may claim the HOPE credit (assuming that the AGI phaseout does not apply) on the parent's return. As an alternative, the parent may elect for that taxable year the deduction for qualified higher education expenses with respect to the dependent child (as described below).[7] On the other hand, if a child is *not* claimed as a dependent by the parent (or by any other taxpayer) for the taxable year, then the child him- or herself has the option of electing either the HOPE credit or deduction for qualified higher education expenses paid during that year.

Qualified tuition and related expenses.—The HOPE credit is available for "qualified tuition and related expenses," meaning tuition, fees, and books required for the enrollment or attendance of an eligible student at an eligible educational institution. Charges and fees associated with meals, lodging, student activities, athletics, insurance, transportation, and similar personal, living or family expenses are not included. The expenses of education involving sports, games, or hobbies are not qualified tuition expenses unless this education is part of the student's degree program.

Qualified tuition and related expenses generally include only out-of-pocket expenses. Qualified tuition and related expenses do not include expenses covered by educational assistance that is not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and related expenses are reduced by any scholarship or fellowship grants excludable from gross income under present-law section 117 and any other tax-free educational benefits received by the student during the taxable year. No reduction of qualified tuition and related expenses is required for a gift, bequest, devise, or inheritance within the meaning of section 102(a). Under the provision, a HOPE credit is not allowed with respect to any education expense for which a deduction is claimed under section 162 or any other section of the Code.[8]

Eligible student.—An eligible student for purposes of the HOPE credit is an individual who is enrolled in a degree, certificate, or other program (including a program of study abroad approved for credit by the institution at which such student is enrolled) leading to a recognized educational credential at an eligible educational institution. The student must pursue a course of study on at least a half-time basis. (In other words, for at least one academic period which begins during the taxable year, the student must carry at least one-half the normal full-time work load for the course of study the student is pursuing.) An eligible student may not have been convicted of a Federal or State felony consisting of the possession or distribution of a controlled substance.

Eligible educational institution.—Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-

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[6] The Treasury Department is granted authority to issue regulations providing that the HOPE credit will be recaptured in cases where the student or taxpayer receives a refund of tuition and related expenses with respect to which a credit was claimed in a prior year.

[7] For any taxable year, a taxpayer may claim the HOPE credit for qualified tuition and related expenses paid with respect to one student and also claim the proposed deduction (described below) for higher education expenses paid with respect to one or more other students. If the HOPE credit is claimed with respect to one student for one or two taxable years, then the proposed deduction for higher education expenses may be available with respect to that student for subsequent taxable years.

[8] In addition, the bill amends present-law section 135 to provide that the amount of qualified higher education expenses taken into account for purposes of that section is reduced by the amount of such expenses taken into account in determining the HOPE credit allowed to any taxpayer with respect to the student for the taxable year.

secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible educational institutions. The institution must be eligible to participate in Department of Education student aid programs.

Regulations.—The Secretary of the Treasury (in consultation with the Secretary of Education) is granted authority to issue regulations to implement the proposal, including regulations providing appropriate rules for recordkeeping and information reporting. These regulations may address the information reports that eligible educational institutions will be required to file to assist students and the IRS in calculating the amount of the HOPE credit potentially available. Where certain terms are defined by reference to the Higher Education Act of 1965, the Secretary of Education has authority to issue regulations, as well as authority to define other education terms as necessary.

Effective date.—The provision is effective for expenses paid after December 31, 1997, for education furnished in academic periods beginning after such date.

Conference Committee Report

In general.—The conference agreement follows the House bill, except: (1) the HOPE credit rate is 100 percent on the first $1,000 of qualified tuition and fees, and 50 percent on the next $1,000 of qualified tuition and fees;[10] (2) the HOPE credit is available only for tuition and fees required for the enrollment or attendance of an eligible student at an eligible institution, and is *not* available for expenses incurred to purchase books; and (3) for a taxable year, a taxpayer may elect with respect to an eligible student the HOPE credit, the 20-percent "Lifetime Learning" credit (as described below), or the exclusion from gross income for certain distributions from an education IRA (as provided by the conference agreement).

Lifetime Learning credit for qualified tuition and fees.—

Allowance of credit.—The conference agreement provides that individual taxpayers are allowed to claim a nonrefundable "Lifetime Learning" credit against Federal income taxes equal to 20 percent of qualified tuition and fees incurred during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or any dependents. For expenses paid after June 30, 1998, and prior to January 1, 2003, up to $5,000 of qualified tuition and fees per taxpayer return will be eligible for the 20-percent Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be $1,000). For expenses paid after December 31, 2002, up to $10,000 of qualified tuition and fees per taxpayer return will be eligible for the 20-percent Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be $2,000).

In contrast to the HOPE credit, a taxpayer may claim the Lifetime Learning credit for an unlimited number of taxable years. Also in contrast to the HOPE credit, the maximum amount of the Lifetime Learning credit that may be claimed on a taxpayer's return will not vary based on the number of students in the taxpayer's family.

The Lifetime Learning credit is phased out ratably over the same phaseout range that applies for purposes of the HOPE credit—i.e., taxpayers with modified AGI between $40,000 and $50,000 ($80,000 and $100,000 for joint returns). The income phase-out ranges will be indexed for inflation occurring after the year 2000, rounded down to the closest multiple of $1,000. The first taxable year for which the inflation adjustment could be made to increase the income phase-out ranges will be 2002.

The Lifetime Learning credit is available in the taxable year the expenses are paid, subject to the requirement that the education commence or continue during that year or during the first three months of the next year. Qualified tuition and fees paid with the proceeds of a loan generally are eligible for the Lifetime Learning credit (rather than repayment of the loan itself).

Dependent students.—As with the HOPE credit, a taxpayer may claim the Lifetime Learning credit with respect to a student who is not the taxpayer or the taxpayer's spouse (e.g., in cases where the student is the taxpayer's child) only if the taxpayer claims the student as a dependent for the taxable year for which the credit is claimed. If a student is claimed as a dependent by the parent or other taxpayer, the student him- or herself is *not* entitled to claim the Lifetime Learning credit for that taxable year on the student's

[10] Thus, an eligible student who incurs $1,000 of qualified tuition and fees is eligible(subject to the AGI phaseout) for a $1,000 HOPE credit; and if such a student incurs $2,000 of qualified tuition and fees, then he or she is eligible for a $1,500 HOPE credit.

The maximum HOPE credit amount will be indexed for inflation occurring after the year 2000, by increasing the cap on qualified tuition and fees subject to the 100-percent credit rate and the cap on such tuition and fees subject to the 50-percent credit rate (both caps rounded down to the closest multiple of $100). The first taxable year for which the inflation adjustment could be made to increase the cap on qualified tuition and fees will be 2002. In addition, under the conference agreement, the income phase-out ranges for the HOPE credit will be indexed for inflation occurring after the year 2000, rounded down to the closest multiple of $1,000. The first taxable year for which the inflation adjustment could be made to increase the income phase-out ranges will be 2002.

own tax return. If a parent (or other taxpayer) claims a student as a dependent, any qualified tuition and related expenses paid by the student are treated as paid by the parent (or other taxpayer) for purposes of the provision.

Election of Lifetime Learning credit, HOPE credit, or exclusion from gross income for certain distributions from education IRAs.—A taxpayer may claim the Lifetime Learning credit for a taxable year with respect to one or more students, even though the taxpayer also claims a HOPE credit (or claims an exclusion from gross income for certain distributions from qualified State tuition programs or education IRAs) for that same taxable year with respect to *other* students. If, for a taxable year, a taxpayer claims a HOPE credit with respect to a student (or claims an exclusion for certain distributions from an education IRA with respect to a student), then the Lifetime Learning credit will *not* be available with respect to that same student for that year (although the Lifetime Learning credit may be available with respect to that same student for other taxable years).

Qualified tuition and fees.—The Lifetime Learning credit is available for "qualified tuition and fees," meaning tuition and fees required for the enrollment or attendance of the eligible student at an eligible institution. Charges and fees associated with meals, lodging, student activities, athletics, insurance, transportation, and similar personal, living or family expenses are not included. The 20-percent credit is not available for expenses incurred to purchase books. The expenses of education involving sports, games, or hobbies are not qualified tuition expenses unless this education is part of the student's degree program.

In contrast to the HOPE credit, qualified tuition and fees for purposes of the Lifetime Learning credit include tuition and fees incurred with respect to undergraduate or graduate-level (and professional degree) courses.[11] In addition to allowing a credit for the tuition and fees of a student who attends classes on at least a half-time basis as part of a degree or certificate program, the Lifetime Learning credit also is available with respect to any course of instruction at an eligible educational institution (whether enrolled in by the student on a full-time, half-time, or less than half-time basis) to acquire or improve job skills of the student.

Qualified tuition and fees are defined in the same manner as under the HOPE credit provisions. Thus, qualified tuition and fees generally include only out-of-pocket expenses. Qualified tuition and fees do not include expenses covered by educational assistance that is not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and fees are reduced by any scholarship or fellowship grants excludable from gross income under present-law section 117 and any other tax-free educational benefits received by the student during the taxable year (such as employer-provided educational assistance excludable under section 127). No reduction of qualified tuition and fees is required for a gift, bequest, devise, or inheritance within the meaning of section 102(a). Under the provision, a Lifetime Learning credit is not allowed with respect to any education expense for which a deduction is claimed under section 162 or any other section of the Code.[12]

Eligible educational institutions.—Eligible educational institutions are (as with the HOPE credit) defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, graduate-level or professional degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible educational institutions. The institution must be eligible to participate in Department of Education student aid programs.

Regulations.—The Secretary of the Treasury (in consultation with the Secretary of Education) is granted authority to issue regulations to implement the provision. The Secretary of the Treasury will have authority to issue regulations providing appropriate rules for recordkeeping and information reporting. These regulations may address the information reports that eligible educational institutions will be required to file to assist students and the IRS in calculating the amount of the Lifetime Learning credit potentially available.

Effective date.—The provision is effective for expenses paid after June 30, 1998, for education furnished in academic periods beginning after such date.

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[11] The HOPE credit is available only with respect to the first two years of a student's undergraduate education.

[12] In addition, the conference agreement amends present-law section 135 to provide that the amount of qualified higher education expenses taken into account for purposes of that section is reduced by the amount of such expenses taken into account in determining the Lifetime Learning credit by any taxpayer with respect to the student for the taxable year.

[¶ 10,145] Act Sec. 202. Law at ¶ 5037, 5089, 5091 and 5611. CCH Explanation at ¶ 157.

Education Tax Incentives—Education Expenses

Senate Committee Report

[*Student loan interest deduction*]

Deduction for student loan interest.—Under the bill, certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, up to a maximum deduction of $2,500 per year. The deduction is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. Months during which the qualified education loan is in deferral or forbearance do not count against the 60-month period. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year. Beginning in 1999, the maximum deduction of $2,500 is indexed for inflation, rounded down to the closest multiple of $50.

A qualified education loan generally is defined as any indebtedness incurred to pay for the qualified higher education expenses of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending (1) post-secondary educational institutions and certain vocational schools defined by reference to section 481 of the Higher Education Act of 1965, or (2) institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training. Qualified higher education expenses are defined as the student's cost of attendance as defined in section 472 of the Higher Education Act of 1965 (generally, tuition, fees, room and board, and related expenses), reduced by (1) any amount excluded from gross income under section 135 (i.e., United States savings bonds used to pay higher education tuition and fees), (2) any amount distributed from a qualified tuition program or education investment account and excluded from gross income (under the provision described above), and (3) the amount of any scholarship or fellowship grants excludable from gross income under present-law section 117, as well as any other tax-free educational benefits, such as employer-provided educational assistance that is excludable from the employee's gross income under section 127. Such expenses must be paid or incurred within a reasonable period before or after the indebtedness is incurred, and must be attributable to a period when the student is at least a half-time student.

The deduction is phased out ratably for taxpayers with modified adjusted gross income (AGI) between $40,000 and $50,000 ($80,000 and $100,000 for joint returns). Modified AGI includes amounts otherwise excluded with respect to income earned abroad (or income from Puerto Rico or U.S. possessions), and is calculated after application of section 86 (income inclusion of certain Social Security benefits), section 219 (deductible IRA contributions), and section 469 (limitation on passive activity losses and credits).[24] Beginning in 2001, the income phase-out ranges are indexed for inflation, rounded down to the closest multiple of $5,000.

Any person in a trade or business or any governmental agency that receives $600 or more in qualified education loan interest from an individual during a calendar year must provide an information report on such interest to the IRS and to the payor.

Effective date.—The provision is effective for payments of interest due after December 31, 1996, on any qualified education loan. Thus, in the case of already existing qualified education loans, interest payments qualify for the deduction to the extent that the 60-month period has not expired. For purposes of counting the 60 months, any qualified education loan and all refinancing (that is treated as a qualified education loan) of such loan are treated as a single loan.

Conference Committee Report

The conference agreement follows the Senate amendment, except that the maximum deduction is phased in over 4 years, with a $1,000 maximum deduction in 1998, $1,500 in 1999, $2,000 in 2000, and $2,500 in 2001. The maximum deduction amount is not indexed for inflation. In addition, the deduction is phased out ratably for individual taxpayers with modified AGI of $40,000-$55,000 ($60,000-$75,000 for joint returns); such income ranges will be indexed for inflation occurring after the year 2002, rounded down to the closest multiple of $5,000. Thus, the first taxable year for which the inflation adjustment could be made will be 2003. For purposes of

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[24] For purposes of sections 86, 135, 219, and 469, adjusted gross income is determined without regard to the deduction for student loan interest.

the deduction, modified AGI includes amounts excludable from gross income under section 137 (qualified adoption expenses).[44]

Qualified higher education expenses are defined as the student's cost of attendance as defined in section 472 of the Higher Education Act of 1965 (generally, tuition, fees, room and board, and related expenses), reduced by (1) any amount excluded from gross income under section 135, (2) any amount distributed from an education IRA and excluded from gross income, and (3) the amount of any scholarship or fellowship grants excludable from gross income under present-law section 117, as well as any other tax-free educational benefits, such as employer-provided educational assistance that is excludable from the employee's gross income under section 127.

The conferees expect that the Secretary of Treasury will issue regulations setting forth reporting procedures that will facilitate the administration of this provision. Specifically, such regulations should require lenders separately to report to borrowers the amount of interest that constitutes deductible student loan interest (i.e., interest on a qualified education loan during the first 60 months in which interest payments are required). In this regard, the regulations should include a method for borrower certification to a lender that the loan proceeds are being used to pay for qualified higher education expenses.

The provision is effective for interest payments due and paid after December 31, 1997, on any qualified education loan.

[¶ 10,150] Act Sec. 203. Law at ¶ 5041. CCH Explanation at ¶ 174.

Education Tax Incentives—Education Expenses

House Committee Report

[*IRA penalty-free withdrawals*]

Penalty-free withdrawals from IRAs for higher education expenses.—The bill provides that the 10-percent early withdrawal tax does not apply to distributions from IRAs (including American Dream IRAs added by the bill) if the taxpayer uses the amounts to pay qualified higher education expenses (including those related to graduate level courses) of the taxpayer, the taxpayer's spouse, or any child, or grandchild of the individual or the individual's spouse.

The penalty-free withdrawal is available for "qualified higher education expenses," meaning tuition, fees, books, supplies, equipment required for enrollment or attendance, and room and board at a post-secondary educational institution (defined by reference to sec 481 of the Higher Education Act of 1965). Qualified higher education expenses are reduced by any amount excludable from gross income under section 135 relating to the redemption of a qualified U.S. savings bond and certain scholarships and veterans benefits.

Effective date.—The provision is effective for distributions after December 31, 1997, with respect to expenses paid after such date for education furnished in academic periods beginning after such date.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 10,175] Act Sec. 211. Law at ¶ 5057, 5179 and 5703. CCH Explanation at ¶ 149.

Education Tax Incentives—Education Expenses

House Committee Report

[*Qualified tuition programs*]

Deduction for qualified higher education expenses and tax treatment of qualified tuition programs and education investment accounts.—

In general.—Individual taxpayers are allowed a deduction of up to $10,000 per student per year for qualified higher education expenses paid by the taxpayer during the taxable year for education furnished to the taxpayer, the taxpayer's spouse, or a dependent. The deduction is allowed regardless of whether the taxpayer otherwise itemizes deductions or claims the standard deduction.[11] A deduction is *not* be allowed under the bill with respect to an otherwise eligible student if the HOPE credit (as described previously) is claimed

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[44] For purposes of section 137, adjusted gross income is determined without regard to the deduction for student loan interest.

[11] The deduction will be claimed after a taxpayer computes adjusted gross income (AGI). The deduction is not a preference item for alternative minimum tax (AMT) purposes.

with respect to that student for the same taxable year.[12]

The deduction is allowed only to the extent that the taxpayer is required to include in gross income for the taxable year amounts distributed from a "qualified tuition program" or "education investment account." In other words, amounts distributed from a qualified tuition program or education investment account that are includible in the taxpayer's gross income (i.e., earnings) and that are used to pay for qualified higher education expenses during the taxable year will be deductible under the bill (subject to a $10,000 annual limit per student). Amounts distributed from qualified tuition programs or education investment accounts generally will be includible in the gross income of the distributee in the same manner as provided under present-law section 72 (to the extent not excluded under any other section, such as section 117).

Under the bill, the deduction is limited to $10,000 per student for each taxable year. Aggregate deductions under the bill with respect to any one student may not exceed $40,000 for all taxable years. A deduction is not permitted with respect to a student after he or she completes the equivalent of the first four years of post-secondary education at an eligible educational institution.

Dependent students.—If a parent (or other taxpayer) claims a student as a dependent for a taxable year, then only the parent (or other taxpayer)—and *not* the student—may claim the deduction for qualified higher education expenses for that taxable year. In such a case where the parent claims the proposed deduction for qualified higher education expenses, amounts includible in gross income by reason of a distribution from a qualified tuition program or education investment account will be includible in the parent's (or other taxpayer's) gross income for that taxable year.[13] If a parent (or other taxpayer) claims a student as a dependent for a taxable year, then all qualified higher education expenses paid that year by both the parent (or other taxpayer) and the student are deemed to be paid by the parent (or other taxpayer). If the student is *not* claimed as a dependent by another taxpayer, then only the student him- or herself may claim the deduction provided for by the bill (or, as an alternative, the HOPE credit described above) on the student's own tax return for the taxable year.[14]

Qualified higher education expenses.—Under the bill, the term "qualified higher education expenses" means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a student at an eligible education institution, as well as room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for Federal financial aid programs under sec. 472 of the Higher Education Act of 1965). Qualified higher education expenses do not include expenses for any graduate level course of a kind normally taken by an individual pursuing a program leading to a law, business, medical, or other advanced academic or professional degree.

Qualified higher education expenses generally include only out-of-pocket expenses. Qualified higher education expenses do not include expenses covered by educational assistance that is not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified higher education expenses are reduced by any scholarship or fellowship grants excludable from gross income under present-law section 117 and any other tax-free educational benefits received by the student during the taxable year. In addition, no deduction is allowed

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[12] If a HOPE credit was claimed with respect to a student for an earlier taxable year (i.e., the student's first or second year of post-secondary education), the deduction provided for by the bill may be claimed with respect to that student for a *subsequent* taxable year.

[13] Such an income inclusion is required on the parent's return only if the parent both claims the student as a dependent *and* elects the deduction provided for by the bill. In contrast, if the parent claims the student as a dependent but elects the HOPE credit, then, if there is any distribution from a qualified tuition program or education investment account during that year, the earnings portion of such distributions will be includible in the student's (or other distributee's) gross income, as provided for by present-law section 529(c)(3).

[14] For example, assume an education investment account (or qualified tuition program account) has a balance of $20,000, of which $12,000 represents contributions of principal and $8,000 represents accumulated earnings. If the student has expenses of $10,000 consisting of $7,000 tuition and related expenses and $3,000 in room and board, a distribution of $10,000 from such account to pay these expenses will, under present-law section 72, be deemed to consist of the pro-rata share of principal and accumulated earnings in the account—in this case, $6,000 in principal and $4,000 in accumulated earnings. If the parent claims the student as a dependent and elects the proposed deduction for qualified higher education expenses, the parent will include the $4,000 of accumulated earnings in the parent's gross income and then is allowed to claim an offsetting deduction for the same $4,000, thus resulting in no tax liability for the $4,000 in earnings. Under no circumstances will the principal portion of any distribution from the account be includible in gross income, nor will a deduction be allowed under the bill for education expenses paid with such principal. Alternatively, the parent may elect to claim the HOPE credit (assuming that the AGI phaseout does not apply and the student is claimed as a dependent and has not yet completed the first two years of post-secondary education), and the $4,000 in accumulated earnings will be includible in the distributee's (i.e., the student's) gross income and an offsetting deduction will *not* be available. Additionally, the qualified expenses for purposes of the HOPE credit will not include room and board expenses, so only $7,000 in expenses will qualify for the HOPE credit. The 50-percent HOPE credit rate will then be applied to this amount, which indicates a credit amount of $3,500, but the credit that could be claimed will be limited to the statutory maximum of $1,500 per student. As a final alternative, if the parent does *not* claim the student as a dependent, then the student may elect to claim either the HOPE credit or the deduction as described above.

under the bill for expenses paid with amounts that are excludible under section 135. No reduction of qualified tuition expenses is required for a gift, bequest, devise, or inheritance within the meaning of section 102(a). If a student's education expenses for a taxable year are deducted under section 162 or any other section of the Code, then no deduction is available for such expenses under the bill.

Eligible students.—To be eligible for the deduction provided for by the bill, a student must be at least a half-time student in a degree or certificate program at an eligible educational institution. For this purpose, a student is at least a half-time student if, during at least one academic period which begins during the taxable year, he or she is carrying at least one-half the normal full-time work load for the course of study the student is pursuing. A student will no longer be an eligible student once he or she has completed the equivalent of the first four years of post-secondary education at an eligible educational institution. An eligible student may not have been convicted of a Federal or State felony consisting of the possession or distribution of a controlled substance.

Eligible educational institution.—Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible educational institutions. The institution must be eligible to participate in Department of Education student aid programs.

Qualified tuition programs and education investments accounts.—Under the bill, a "qualified tuition program" means any qualified State tuition program, generally as defined under present-law section 529, as well as any program established and maintained by one or more eligible educational institutions (which may be private institutions that are not State-owned) that satisfy the requirements under section 529 (other than present-law, State ownership rule). An "education investment account" means a trust which is created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses of the account holder and which satisfies certain other requirements.

Contributions to qualified tuition programs or education investment accounts may be made only in cash.[15] Such contributions may not be made after the designated beneficiary or account holder reaches age 18. Any balance remaining in a qualified tuition program or education investment account must be distributed within 30 days after the earlier of the date that the beneficiary or account holder becomes 30 years old (or dies) or the date that the beneficiary or account holder completes the equivalent of the first four years of post-secondary education at one or more eligible institutions. Transfers or rollovers of credits or account balances from one account benefiting one beneficiary to another account benefiting another beneficiary will not be considered a distribution from a qualified tuition program or education investment account (nor will a change in the designated beneficiary or account holder) if the new beneficiary is a member of the family of the old beneficiary.[16] In the case of an education investment account or qualified tuition program maintained by one or more private educational institutions, contributions to an account established on behalf of a particular beneficiary (or to a program on behalf of a named beneficiary) may not exceed $5,000 per year, with an aggregate limit of $50,000 for contributions on behalf of that beneficiary for all years. The $50,000 aggregate contribution limit per beneficiary is applied by taking into account all amounts contributed to all education investment accounts for the beneficiary for the current taxable year and all prior taxable years, as well as all amounts contributed to all qualified tuition programs on behalf of such beneficiary for the current taxable year and all prior taxable years.[17]

Qualified tuition programs and education investment accounts (as separate legal entities) will

[15] The bill allows taxpayers to redeem U.S. Savings Bonds and be eligible for the exclusion under section 135 (as if the proceeds were used to pay qualified higher education expenses) if the proceeds from the redemption are contributed to a qualified tuition program or education investment account on behalf of the taxpayer, the taxpayer's spouse, or a dependent. In such a case, the beneficiary's or account holder's basis in the bond proceeds contributed on his or her behalf to the qualified tuition program or education investment will be the contributor's basis in the bonds (i.e., the original purchase price paid by the contributor for such bonds).

The bill also provides that funds from an education investment account are deemed to be distributed to pay qualified higher education expenses if the funds are used to purchase tuition credits from, or to make contributions to, a qualified tuition program for the benefit of the account holder.

[16] For this purpose, a "member of the family" means persons described in paragraphs (1) through (8) of section 152(a), and any spouse of such persons.

[17] To the extent contributions exceed the $50,000 aggregate limit, an excise tax penalty may be imposed on the contributor under present-law section 4973, unless the excess contributions (and any earnings thereon) are returned to the contributor before the due date for the return for the taxable year in which the excess contribution is made.

State-sponsored qualified tuition programs will continue to be governed by the rule contained in present-law section 529(b)(7) that such programs provide adequate safeguards to prevent contributions on behalf of a designated beneficiary in excess of those necessary to provide for the qualified higher education expenses of the beneficiary. State-sponsored qualified tuition programs will *not* be subject to a specific dollar cap under section 529 on annual (or aggre-

be exempt from Federal income tax, other than taxes imposed under the present-law unrelated business income tax (UBIT) rules.[18]

Under the bill, an additional tax of 10 percent will be imposed on distributions from qualified tuition programs or education investment account to the extent the distribution exceeds qualified higher education expenses paid by the taxpayer (and is not made on account of the death, disability, or scholarship received by the designated beneficiary or account holder).

Estate and gift tax treatment.—For Federal estate and gift tax purposes, any contribution to a qualified tuition program or education investment account will be treated as a completed gift of a present interest from the contributor to the beneficiary at the time of the contribution. Thus, annual contributions—which cannot exceed $5,000 per year in the case of an education investment account or qualified tuition program maintained by one or more private education institutions—will be eligible for the present-law gift tax exclusion provided by Code section 2503(b) and also will be excludable for purposes of the generation-skipping transfer tax (provided that the contribution, when combined with any other contributions made by the donor to that same beneficiary, does not exceed the annual $10,000 gift-tax exclusion limit). Similar gift tax and generation-skipping tax treatment will apply to contributions of up to $10,000 per donor per beneficiary made to a State-sponsored qualified tuition program. Contributions to a qualified tuition program (either a State-sponsored program or one maintained by a private education institution) or to an education investment account will not, however, be eligible for the educational expense exclusion provided by Code section 2503(e). In no event will a distribution from a qualified tuition program or education investment account be treated as a taxable gift.

Transfers or rollovers of credits or account balances from an account benefiting one beneficiary to an account benefiting another beneficiary (or a change in the designated beneficiary) will not be treated as a taxable gift to the extent that the new beneficiary is: (1) a member of the family of the old beneficiary (as defined above), and (2) assigned to the same generation as the old beneficiary (within the meaning of Code section 2651). In all other cases, a transfer from one beneficiary to another beneficiary (or a change in the designated beneficiary) will be treated as a taxable gift from the old beneficiary to the new beneficiary to the extent it exceeds the $10,000 present-law gift tax exclusion. Thus, a transfer of an account from a brother to his sister will not be treated as a taxable gift, whereas a transfer from a father to his son will be treated as a taxable gift (to the extent it exceeds the $10,000 present-law gift tax exclusion).

For estate tax purposes, the value of any interest in a qualified tuition program or education investment account will be includible in the estate of the designated beneficiary. In no event will such interests be includible in the estate of the contributor.

Effective date.—The deduction for qualified higher education expenses, and the expansion of the definition of qualified higher education expenses under sec. 529 to cover room and board expenses, are effective for expenses paid after December 31, 1997, for education furnished in academic periods beginning after such date. The provisions governing the tax-exempt status of qualified tuition plans and education investment accounts generally are effective after December 31, 1997. The gift tax provisions are effective for contributions (or transfers) made after the date of enactment, and the estate tax provisions are effective for decedents dying after June 8, 1997.

Conference Committee Report

Qualified State tuition programs.—The conference agreement makes the following modifications to present-law section 529, which governs the tax treatment of qualified State tuition programs.

Room and board expenses.—The conference agreement expands the definition of "qualified higher education expenses" under section 529(e)(3) to include room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for Federal financial aid programs under sec. 472 of the Higher Education Act of 1965) for any period during which the student is at least a half-time student.

Eligible educational institution.—The conference agreement expands the definition of "eligible educational institution" for purposes of section 529 by defining such term by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, a graduate-level or professional degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible institutions.

(Footnote Continued)

gate) contributions that can be made under the program on behalf of a named beneficiary.

[18] An interest in a qualified tuition program is not treated as debt for purposes of the debt-financed property UBIT rules of section 514.

The institution must be eligible to participate in Department of Education student aid programs.

Definition of "member of family".—The conference agreement expands the definition of the term "member of the family" for purposes of allowing tax-free transfers or rollovers of credits or account balances in qualified State tuition programs (and redesignations of named beneficiaries), so that the term means persons described in paragraphs (1) through (8) of section 152(a)—e.g., sons, daughters, brothers, sisters, nephews and nieces, certain in-laws, etc.—and any spouse of such persons.[38]

Prohibition against investment direction.—The conference clarifies the present-law rule contained in section 529(b)(5) that qualified State tuition programs may not allow contributors or designated beneficiaries to direct the investment of contributions to the program (or earnings thereon) by specifically providing that contributors and beneficiaries may not "directly or indirectly" direct the investment of contributions to the program (or earnings thereon).

Interaction with HOPE credit and Lifetime Learning credit.—Under the conference agreement (as under present law), no amount will be includible in the gross income of a contributor to, or beneficiary of, a qualified State tuition program with respect to any contribution to or earnings on such a program until a distribution is made from the program, at which time the earnings portion of the distribution (whether made in cash or in-kind) will be includible in the gross income of the distributee. However, to the extent that a distribution from a qualified State tuition program is used to pay for qualified tuition and fees, the distributee (or another taxpayer claiming the distributee as a dependent) will be able to claim the HOPE credit or Lifetime Learning credit provided for by the conference agreement with respect to such tuition and fees (assuming that the other requirements for claiming the HOPE credit or Lifetime Learning credit are satisfied and the modified AGI phaseout for those credits does not apply).[39]

Effective date.—The modifications to section 529 generally are effective after December 31, 1997. The expansion of the term "qualified higher education expenses" to cover certain room and board expenses is effective as if included in the Small Business Job Protection Act of 1996 (enacted on August 20, 1996).

* * *

Estate and gift tax treatment.—The conference agreement follows the House bill with respect to the estate and gift tax treatment of contributions to qualified State tuition programs and education IRAs, except that a special rule is provided in the case of contributions that exceed the annual gift tax exclusion limit (presently $10,000 in the case of an individual or $20,000 in the case of a married couple that splits their gifts, but this amount is scheduled to increase under other provisions of the conference agreement). For such contributions, the contributor may elect to have the contribution treated as if made ratably over a five-year period.

Thus, for Federal estate and gift tax purposes, any contribution to a qualified tuition program or education IRA will be treated as a completed gift of a present interest from the contributor to the beneficiary at the time of the contribution. Annual contributions are eligible for the present-law gift tax exclusion provided by Code section 2503(b) and also are excludable for purposes of the generation-skipping transfer tax (provided that the contribution, when combined with any other contributions made by the donor to that same beneficiary, does not exceed the annual gift-tax exclusion limit of $10,000, or $20,000 in the case of a married couple).

If a contribution in excess of $10,000 ($20,000 in the case of a married couple) is made in one year—which, under the conference agreement, can occur only in the case of a qualified State tuition program and not an education IRA (which cannot receive contributions in excess of $500 per year)—the contributor may elect to have the contribution treated as if made ratably over five years beginning in the year the contribution is made. For example, a $30,000 contribution to a qualified State tuition program would be treated as five annual contributions of $6,000, and the donor could therefore make up to $4,000 in other transfers to the beneficiary each year without payment of gift tax. Under this rule, a donor may contribute up to $50,000 every five years ($100,000 in the case of a married couple) with no gift tax consequences, assuming no other gifts are made from the donor to the beneficiary in the five-year period. A gift tax return must be filed with respect to any contribution in excess of the

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[38] The conference agreement also provides a special rule that, in the case of any contract issued prior to August 20, 1996 (i.e., the date of enactment of section 529), section 529(c)(3)(C) will be applied without regard to the requirement that a distribution be transferred to a member of the family or the requirement that a change in beneficiaries may be made only to a member of the family.

[39] In cases where in-kind benefits are provided to a beneficiary under a qualified State prepaid tuition program, present-law section 529(c)(3)(B) provides that the provision of such benefits is treated as a distribution to the beneficiary. Thus, to the extent such in-kind benefits, if paid for by the beneficiary, would constitute payment of qualified tuition and fees for purposes of the HOPE credit or Lifetime Learning credit, the beneficiary (or another taxpayer claiming the beneficiary as a dependent) may be able to claim the HOPE credit or Lifetime Learning credit with respect to payments that are deemed to be made by the beneficiary with respect to the in-kind benefit.

annual gift-tax exclusion limit, and the election for five-year averaging must be made on the contributor's gift tax return.

If a donor making an over-$10,000 contribution dies during the five-year averaging period, the portion of the contribution that has not been allocated to the years prior to death is includible in the donor's estate. For example, if a donor makes a $40,000 contribution, elects to treat the transfer as being made over a five-year period, and dies the following year, $8,000 would be allocated to the year of contribution, another $8,000 would be allocated to the year of death, and the remaining $24,000 would be includible in the estate.

If a beneficiary's interest is rolled over to another beneficiary, there are no transfer tax consequences if the two beneficiaries are in the same generation. If a beneficiary's interest is rolled over to a beneficiary in a lower generation (e.g., parent to child or uncle to niece), the five-year averaging rule described above may be applied to exempt up to $50,000 of the transfer from gift tax.

The Federal estate and gift tax treatment of educational accounts has no effect on the actual rights and obligations of the parties pursuant to the terms of the contracts under State law.

Effective date.—The gift tax provisions are effective for contributions (or transfers) made after the date of enactment, and the estate tax provisions are effective for decedents dying after June 8, 1997.

[¶ 10,185] Act Sec. 213. Law at ¶ 5011, 5057, 5181, 5527, 5529 and 5703. CCH Explanation at ¶ 145.

Education Tax Incentives—Education Expenses

Conference Committee Report

[*Education IRAs*]

Senate Amendment.—

* * *

Qualified tuition programs and education IRAs.—Under the Senate amendment, a "qualified tuition program" means any qualified State-sponsored tuition program, defined under section 529 (as modified by the bill), as well as any program established and maintained by one or more eligible educational institutions (which could be private institutions) that satisfy the requirements under section 529 (other than present-law State ownership rule). An "education IRA" means a trust (or custodial account) which is created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses (and qualified elementary and secondary education expenses) of the account holder and which satisfies certain other requirements.

Contributions to qualified tuition programs or education IRAs may be made only in cash.[28] Such contributions may not be made after the designated beneficiary or account holder reaches age 18. Annual contributions to a qualified tuition program not maintained by a State (i.e., a qualified tuition program operated by one or more private schools) or to an education IRA are limited to $2,000 per beneficiary or account holder, *plus* the amount of any child credit (as provided for by the Senate amendment) that is allowed for the taxable year with respect to the beneficiary or account holder.[29] Thus, in the case of any child with respect to whom the maximum $500 child credit is allowed for the taxable year, the contribution limit with respect to such child for the year will be $2,500.[30] Trustees of qualified tuition programs not maintained by a State and trustees of education IRAs are prohibited from accepting contributions to any account on behalf of a beneficiary in excess of $2,500 for any year (except in cases involving certain tax-free rollovers, as described below).[31]

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[28] The Senate amendment allows taxpayers to redeem U.S. Savings Bonds and be eligible for the exclusion under section 135 (as if the proceeds were used to pay qualified higher education expenses) if the proceeds from the redemption are contributed to a qualified tuition program or education IRA on behalf of the taxpayer, the taxpayer's spouse, or a dependent. In such as case, the beneficiary's or account holder's basis in the bond proceeds contributed on his or her behalf to the qualified tuition program or education IRA will be the contributor's basis in the bonds (i.e., the original purchase price paid by the contributor for such bonds).

The Senate amendment also provides that funds from an education IRA are deemed to be distributed to pay qualified higher education expenses if the funds are used to make contributions to (or purchase tuition credits from) a qualified tuition program for the benefit of the account holder.

[29] State-sponsored qualified tuition programs will continue to be governed by the rule contained in present-law section 529(b)(7) that such programs provide adequate safeguards to prevent contributions on behalf of a designated beneficiary in excess of those necessary to provide for the qualified higher education expenses of the beneficiary. State-sponsored qualified tuition will *not* be subject to a specific dollar limit on annual contributions that can be made under the program on behalf of a designated beneficiary.

[30] The maximum contribution limit for the year is increased even if the child is younger than age 13--that is, even in cases where the parent is not *required* (under the provision described previously) but may elect to deposit an amount equal to the child credit into a qualified tuition program or education IRA on behalf of the child.

[31] The annual $2,000 to $2,500 contribution limit is applied by taking into account all contributions made to any qualified tuition program not maintained by a State *and* any education IRA on behalf of a designated individual (but not any contributions made to State-sponsored qualified tuition programs). To the extent contributions exceed the annual contribution limit, an excise tax penalty may be

If any balance remaining in an education IRA is not distributed by the time that the account holder becomes 30 years old, then the account will be deemed to be an IRA Plus account (as provided for by the bill and described below) established on behalf of the same account holder.[32] The Senate amendment allows (but does not require) tax-free transfers or rollovers of account balances from a qualified tuition program to an IRA Plus account when the beneficiary becomes 30 years old, provided that the funds from the qualified tuition program account are deposited in the IRA Plus account within 60 days after being distributed from the qualified tuition program.[33] In addition, the Senate amendment allows tax-free transfers or rollovers of credits or account balances from one qualified tuition program or education IRA account benefiting one beneficiary to another program or account benefiting another beneficiary (as well as redesignations of the named beneficiary), provided that the new beneficiary is a member of the family of the old beneficiary.[34]

Qualified tuition programs and education IRAs (as separate legal entities) will be exempt from Federal income tax, other than taxes imposed under the present-law unrelated business income tax (UBIT) rules.[35]

Under the Senate amendment, an additional 10-percent penalty tax will be imposed on any distribution from a qualified tuition program not maintained by a State or from an education IRA to the extent that the distribution exceeds qualified higher education expenses (or, in the case of an education IRA, qualified elementary and secondary education expenses) incurred by the taxpayer (and is not made on account of the death, disability, or scholarship received by the designated beneficiary or account holder).[36]

* * *

Effective date.—* * * In addition, in the case of education IRAs, the provision applies to qualified elementary and secondary expenses paid in taxable years beginning after December 31, 2000. The provisions governing contributions to, and the tax-exempt status of, qualified tuition plans and education IRAs generally apply after December 31, 1997. * * *

Conference Agreement.—

* * *

Education IRAs.—The conference agreement generally follows the Senate amendment with respect to the treatment of education IRAs, with the following modifications.

Contribution limit.—Under the conference agreement, annual contributions to education IRAs are limited to $500 per beneficiary. This $500 annual contribution limit for education IRAs is phased out ratably for contributors with modified AGI between $95,000 and $110,000 ($150,000 and $160,000 for joint returns). Individuals with modified AGI above the phase-out range are not allowed to make contributions to an education IRA established on behalf of any other individual.[40]

Qualified expenses.—Education IRAs must be created exclusively for the purpose of paying qualified higher education expenses, meaning post-secondary tuition, fees, books, supplies, equipment, and certain room and board expenses, and *not* including elementary or secondary school expenses.

Expansion of exclusion for part-time students.—The conference agreement provides that distributions from an education IRA are excludable from gross income to the extent that the distribution does not exceed qualified higher education expenses incurred by the beneficiary during the year the distribution is made, regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or less than half-time basis. However, room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for Federal financial aid programs under sec. 472 of the Higher Education Act of 1965) are qualified higher education expenses only if the student incurring such expenses is enrolled at an eligible educational institution on at least a half-time basis.

(Footnote Continued)

imposed on the contributor under present-law section 4973, unless the excess contributions (and any earnings thereon) are returned to the contributor before the due date for the return for the taxable year during which the excess contribution is made.

[32] In such cases, the 5-year holding period applicable to IRA Plus accounts begins with the taxable year in which the education IRA is deemed to be an IRA Plus account.

[33] In the event of such a rollover, the 5-year holding period applicable to IRA Plus accounts begins with the taxable year in which the rollover occurs.

[34] For this purpose, a "member of the family" means persons described in paragraphs (1) through (8) of section 152(a), and any spouse of such persons.

[35] An interest in a qualified tuition program is not treated as debt for purposes of the debt-financed property UBIT rules of section 514.

[36] Distributions from State-sponsored qualified tuition programs will *not* be subject to this 10-percent additional penalty tax, but will continue to be governed by the present-law section 529(b)(3) rule that the State-sponsored programs themselves are required to impose a "more than de minimis penalty" on any refund of earnings not used for qualified higher education expenses (other than in cases where the refund is made on account of death or disability of, or receipt of a scholarship by, the beneficiary).

[40] The conference agreement clarifies that no amount is includible in the gross income of a beneficiary of an education IRA with respect to any contribution to or earnings on such account.

Termination of education IRAs.—Under the conference agreement, any balance remaining in an education IRA at the time a beneficiary becomes 30 years old must be distributed, and the earnings portion of such a distribution will be includible in gross income of the beneficiary and subject to an additional 10-percent penalty tax because the distribution was not for educational purposes. However, as under the Senate amendment, prior to the beneficiary reaching age 30, the conference agreement allows tax-free (and penalty-free) transfers and rollovers of account balances from one education IRA benefiting one beneficiary to another education IRA benefiting a different beneficiary (as well as redesignations of the named beneficiary), provided that the new beneficiary is a member of the family of the old beneficiary.[41]

Interaction with qualified State tuition programs.—The conference agreement provides that no contribution may be made by any person to an education IRA established on behalf of a beneficiary during any taxable year in which any contributions are made by anyone to a qualified State tuition program (defined under sec. 529) on behalf of the same beneficiary.

Interaction with HOPE credit and Lifetime Learning credit.—The conference agreement provides that, in any taxable year in which an exclusion from gross income is claimed with respect to a distribution from an education IRA on behalf of a beneficiary, neither a HOPE credit nor a Lifetime Learning credit may be claimed with respect to educational expenses incurred during that year on behalf of the same beneficiary. The HOPE credit or Lifetime Learning credit will be available in *other* taxable years with respect to that beneficiary (provided that no exclusion is claimed in such other taxable years for distributions from an education IRA on behalf of the beneficiary and provided that the requirements of the HOPE credit or Lifetime Learning credit are satisfied in such other taxable years).

Effective date.—The provisions governing education IRAs apply to taxable years beginning after December 31, 1997.

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[¶ 10,215] Act Sec. 221. Law at ¶ 5051. CCH Explanation at ¶ 156.

Education Tax Incentives—Education-Related Provisions

House Committee Report

[*Employer-provided educational assistance*]

Extension of exclusion for employer-provided educational assistance.—The proposal would extend the exclusion for employer-provided educational assistance to courses of instruction beginning before December 31, 1997. As under present law, the exclusion will not apply to graduate-level courses.

Effective date.—The provision would be effective with respect to taxable years beginning after December 31, 1996.

Conference Committee Report

The conference agreement follows the House bill, with modifications. Under the conference agreement, the exclusion for undergraduate education is extended with respect to courses beginning before June 1, 2000. As under the House bill, the exclusion does not apply with respect to graduate-level courses.

[¶ 10,220] Act Sec. 222. Law at ¶ 5063. CCH Explanation at ¶ 353.

Education Tax Incentives—Education-Related Provisions

Senate Committee Report

[*Qualified 501(c)(3) bonds: $150 million limit*]

Modification of $150 million limit on qualified 501(c)(3) bonds other than hospital bonds.—The $150 million limit is repealed for bonds issued after the date of enactment to finance capital expenditures incurred after the date of the enactment.

Effective date.—The provision is effective for bonds issued after the date of enactment to finance capital expenditures incurred after the date of enactment.

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[41] For this purpose, a "member of the family" means--as under the conference agreement modifications to section 529--persons described in paragraphs (1) through (8) of section 152(a), and any spouse of such persons.

Conference Committee Report

The conference agreement follows the Senate amendment.

Effective date.—The provision is effective for bonds issued after the date of enactment. Because this provision of the conference agreement applies only to bonds issued with respect to capital expenditures incurred after the date of enactment, the $150 million limit will continue to govern issuance of other non-hospital qualified 501(c)(3) bonds (e.g., refunding bonds or new-money bonds for capital expenditures incurred before the date of enactment). Thus, the conferees understand that bond issuers will continue to need Treasury Department guidance on the application of this limit in the future and expect that the Treasury will continue to provide interpretative rules on this limit.

[¶ 10,225] Act Sec. 223. Law at ¶ 5065. CCH Explanation at ¶ 359.

Education Tax Incentives—Education-Related Provisions

Senate Committee Report

[*Arbitrage rebate: Government bonds*]

Expansion of arbitrage rebate exception for certain bonds.—The bill provides that up to $5 million dollars of bonds used to finance public school capital expenditures incurred after December 31, 1997, are excluded from application of the present-law $5 million dollar limit. Thus, small issuers will continue to benefit from the small issue exception from arbitrage rebate if they issue no more than $10 million in governmental bonds per calendar year and no more than $5 million of the bonds is used to finance expenditures other than for public school capital expenditures.

Effective date.—The provision is effective for bonds issued after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 10,230] Act Sec. 224. Law at ¶ 5077. CCH Explanation at ¶ 519.

Education Tax Incentives—Education-Related Provisions

House Committee Report

[*Corporate contributions of computer technology*]

Enhanced deduction for corporate contributions of computer technology and equipment.—The bill expands the list of qualified contributions that would qualify for the augmented deduction currently available under Code section 170(e)(3) and 170(e)(4). Under the bill, qualified contributions mean gifts of computer technology and equipment (i.e., computer software, computer or peripheral equipment, and fiber optic cable related to computer use) to be used within the United States for educational purposes in any of grades K-12.

Eligible donees are (1) any educational organization that normally maintains a regular faculty and curriculum and has a regularly enrolled body of pupils in attendance at the place where its educational activities are regularly carried on; and (2) Code section 501(c)(3) entities that are organized primarily for purposes of supporting elementary and secondary education. A private foundation also is an eligible donee, provided that, within 30 days after receipt of the contribution, the private foundation contributes the property to an eligible donee described above.

Qualified contributions are limited to gifts made no later than two years after the date the taxpayer acquired or substantially completed the construction of the donated property. Such donated property could be computer technology or equipment that is inventory or depreciable trade or business property in the hands of the donor. The bill permits payment by the donee organization of shipping, transfer, and installation costs.[23] The special treatment applies only to donations made by C corporations; as under present law section 170(e)(4), S corporations, personal holding companies, and service organizations are not eligible donors.

Effective date.—The provision is effective for contributions made in taxable years beginning after 1997.

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[23] In the case of contributions made through private foundations, the bill permits the payment by the private foundation of shipping, transfer, and installation costs.

Conference Committee Report

The conference agreement follows the House bill, except that the provision is sunset after three years. Thus, the provision is effective for contributions made in taxable years beginning after 1997 and before January 1, 2001. In addition, the conference agreement clarifies that the original use of the donated property must commence with the donor or the donee. Accordingly, qualified contributions generally are limited to property that is no more than two years old.

[¶ 10,235] Act Sec. 225. Law at ¶ 5045. CCH Explanation at ¶ 159.

Education Tax Incentives—Education-Related Provisions

House Committee Report

[*Student loan cancellation*]

Treatment of cancellation of certain student loans.—The bill expands section 108(f) so that an individual's gross income does not include forgiveness of loans made by tax-exempt charitable organizations (e.g., educational organizations or private foundations) if the proceeds of such loans are used to pay costs of attendance at an educational institution or to refinance outstanding student loans and the student is not employed by the lender organization. As under present law, the section 108(f) exclusion applies only if the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers. In addition, in the case of loans made by tax-exempt charitable organizations, the student's work must fulfill a public service requirement. The student must work in an occupation or area with unmet needs and such work must be performed for or under the direction of a tax-exempt charitable organization or a governmental entity.

The exclusion also is expanded to cover forgiveness of direct student loans made through the William D. Ford Federal Direct Loan Program where loan repayment and forgiveness are contingent on the borrower's income level and any unpaid amounts are forgiven in full by the Secretary of Education at the end of a 25-year period. Thus, Federal Direct Loan borrowers who have elected the income-contingent repayment option and who have not repaid their loans in full at the end of a 25-year period would not be required to include the outstanding loan balance in income as a result of the forgiveness of the loan.

Effective date.—The provision applies to discharges of indebtedness after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, except that the conference agreement does not include the provision expanding the exclusion to cover forgiveness of direct student loans made through the William D. Ford Federal Direct Loan Program where loan repayment and forgiveness are contingent on the borrower's income level and any unpaid amounts are forgiven in full by the Secretary of Education at the end of a 25-year period.

[¶ 10,240] Act Sec. 226. Law at ¶ 5391 and 5393. CCH Explanation at ¶ 161.

Education Tax Incentives—Education-Related Provisions

Conference Committee Report

[*Qualified zone academy bonds*]

Under the conference agreement, certain financial institutions (i.e., banks, insurance companies, and corporations actively engaged in the business of lending money) that hold "qualified zone academy bonds" are entitled to a nonrefundable tax credit in an amount equal to a credit rate (set by the Treasury Department) multiplied by the face amount of the bond. The credit rate applies to all such bonds purchased in each month. A taxpayer holding a qualified zone academy bond is entitled to a credit for each year the taxpayer holds the bond. The credit is includible in gross income, but may be claimed against regular income tax and AMT liability.

The Treasury Department will set the credit rate each month so that such bonds can be issued without discount and without any interest cost to the issuer. The maximum term of the bond issued in a given month also is determined by the Treasury Department so that the present value of the obligation to repay the bond is 50 percent of the face value of the bond. Such present value will be determined using as a discount rate the average annual interest rate of tax-exempt obligations with a term of 10 years or more issued during the month.

"Qualified zone academy bonds" are defined as any bond issued by a State or local government, provided that (1) 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in an empowerment zone or enterprise community (including empowerment zones designated or authorized to be designated under the conference agreement), or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

A total of $400 million of "qualified zone academy bonds" may be issued in each of 1998 and 1999. The $800 million aggregate bond cap will be allocated to the States according to their respective populations of individuals below the poverty line. A State may carry over any unused allocation into subsequent years. Each State, in turn, will allocate the credit to qualified zone academies within such State.

Effective date.—The provision is effective for bonds issued after 1997.

[¶ 10,255] Act Sec. 301. Law at ¶ 5085. CCH Explanation at ¶ 172 and 173.

Savings and Investment Incentives

Senate Committee Report

[*IRA deduction*]

Individual retirement arrangements.—

In general.—The bill (1) increases the AGI phase-out limits for deductible IRAs, (2) provides that an individual is not considered an active participant in an IRA merely because the individual's spouse is an active participant, * * *

Increase income phase-out ranges for deductible IRAs.—The bill increases the AGI phase-out range for deductible IRA contributions as follows:

[In thousands of dollars]

	Phase-Out Range	
Taxable years beginning in:	*Single Taxpayers*	*Joint Returns*
1998 and 1999	$30,000—$40,000	$50,000—$60,000
2000 and 2001	$35,000—$45,000	$60,000—$70,000
2002 and 2003	$40,000—$50,000	$70,000—$80,000
2004 and thereafter	$50,000—$60,000	$80,000—$100,000

Active participant rule.—The bill provides that an individual is not considered an active participant in an employer-sponsored plan merely because the individual's spouse is an active participant.

* * *

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment, with modifications.

Under the conference agreement, as under the Senate amendment, an individual is not considered an active participant in an employer-sponsored retirement plan merely because the individual's spouse is an active participant. However, under the conference agreement, the maximum deductible IRA contribution for an individual who is not an active participant, but whose spouse is, is phased out for taxpayers with AGI between $150,000 and $160,000.

Under the conference agreement, the deductible IRA income phase-out limits are increased as follows:

Joint Returns

Taxable years beginning in:	*Phase–out range*
1998	$ 50,000 – $60,000
1999	$ 51,000 – $61,000
2000	$ 52,000 – $62,000
2001	$ 53,000 – $63,000

2002	$ 54,000 – $64,000
2003	$ 60,000 – $70,000
2004	$ 65,000 – $75,000
2005	$ 70,000 – $80,000
2006	$ 75,000 – $85,000
2007 and thereafter	$80,000 – $100,000

Single Taxpayers

Taxable years beginning in:	*Phase-out range*
1998	$30,000 – $40,000
1999	$31,000 – $41,000
2000	$32,000 – $42,000
2001	$33,000 – $43,000
2002	$34,000 – $44,000
2003	$40,000 – $50,000
2004	$45,000 – $55,000
2005 and thereafter	$50,000 – $60,000

The following examples illustrate the income phase-out rules.

Example 1.—Suppose for a year W is an active participant in an employer-sponsored retirement plan, and W's husband, H, is not. Further assume that the combined AGI of H and W for the year is $200,000. Neither W nor H is entitled to make deductible contributions to an IRA for the year.

Example 2.—Same as example 1, except that the combined AGI of W and H is $125,000. H can make deductible contributions to an IRA. However, a deductible contribution could not be made for W.

[¶ 10,260] Act Sec. 302. Law at ¶ 5085, 5139, 5141 and 5527. CCH Explanation at ¶ 166.

Savings and Investment Incentives

Senate Committee Report

[*IRA Plus accounts*]

Individual retirement arrangements.—

In general.—The bill * * * (4) replaces present-law nondeductible IRAs with a new IRA called the IRA Plus. All individuals may make nondeductible contributions of up to $2,000 annually to an IRA Plus. No income limitations apply to IRA Plus accounts; however, the $2,000 maximum contribution limit is reduced to the extent an individual makes deductible contributions to an IRA. An IRA Plus is an IRA which is designated at the time of establishment as an IRA Plus in the manner prescribed by the Secretary. Qualified distributions from an IRA Plus are not includible in income.

* * *

IRA Plus accounts

Contributions to IRA Plus accounts.—The maximum annual contribution that may be made to an IRA Plus is the lesser of $2,000 (reduced by deductible IRA contributions) or the individual's compensation for the year. As under the present-law rules relating to deductible IRAs, a contribution of up to $2,000 for each spouse may be made to an IRA Plus provided the combined compensation of the spouses is at least equal to the contributed amount.

Contributions to an IRA Plus may be made even after the individual for whom the account is maintained has attained age 70-1/2.

Taxation of distributions.—Qualified distributions from an IRA Plus are not includible in gross income, nor subject to the additional 10-percent tax on early withdrawals. A qualified distribution is a distribution that (1) is made after the 5-taxable year period beginning with the first taxable year in which the individual made a contribution to an IRA Plus[29], and (2) which is (a) made on or after the date on which the individual attains age 59-1/2, (b) made to a beneficiary (or to the individual's estate) on or after the death of the individual, (c) attributable to the individual's being disabled, or (d) a qualified special purpose distribution. Qualified special purpose distributions are distributions that are exempt from the 10-percent early withdrawal tax because they are for first-time homebuyer expenses or long-term unemployed individuals.

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[29] As is the case with IRAs generally, contributions to an IRA Plus may be made for a year by the due date for the individual's tax return for the year (determined without regard to extensions). In the case of a contribution to an IRA Plus made after the end of the taxable year, the 5-year holding period begins with the taxable year to which the contribution relates, rather than the year in which the contribution is actually made.

Distributions from an IRA Plus that are not qualified distributions are includible in income to the extent attributable to earnings, and subject to the 10-percent early withdrawal tax (unless an exception applies). The same exceptions to the early withdrawal tax that apply to IRAs apply to IRA Plus accounts.

An ordering rule applies for purposes of determining what portion of a distribution that is not a qualified distribution is includible in income. Under the ordering rule, distributions from an IRA Plus are treated as made from contributions first, and all an individual's IRA Plus accounts are treated as a single IRA Plus. Thus, no portion of a distribution from an IRA Plus is treated as attributable to earnings (and therefore includible in gross income) until the total of all distributions from all the individual's IRA Plus accounts exceeds the amount of contributions.

Distributions from an IRA Plus may be rolled over tax free to another IRA Plus.

Conversions of an IRA to an IRA Plus.—All or any part of amounts in a present-law deductible or nondeductible IRA may be converted into an IRA Plus. If the conversion is made before January 1, 1999, the amount that would have been includible in gross income if the individual had withdrawn the converted amounts is included in gross income ratably over the 4-taxable year period beginning with the taxable year in which the conversion is made. The early withdrawal tax does not apply to such conversions.[30]

A conversion of an IRA into an IRA Plus can be made in a variety of different ways and without taking a distribution. For example, an individual may make a conversion simply by notifying the IRA trustee. Or, an individual may make the conversion in connection with a change in IRA trustees through a rollover or a trustee-to-trustee transfer. If a part of an IRA balance is converted into an IRA Plus, the IRA Plus amounts may have to be held separately.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment, with modifications. Under the conference agreement, the new IRA is called the "Roth IRA" rather than the IRA Plus. The maximum contribution that can be made to a Roth IRA is phased out for individuals with AGI between $95,000 and $110,000 and for joint filers with AGI between $150,000 and $160,000. Under the conference agreement, distributions to long-term unemployed individuals do not qualify as special purpose distributions. Thus, only first-time homebuyer expenses (as defined under the Senate amendment) qualify as special purpose distributions.

Under the conference agreement, only taxpayers with AGI of less than $100,000[51] are eligible to roll over or convert an IRA into a Roth IRA.

The conference agreement retains present-law nondeductible IRAs. Thus, an individual who cannot (or does not) make contributions to a deductible IRA or a Roth IRA can make contributions to a nondeductible IRA. In no case can contributions to all an individual's IRAs for a taxable year exceed $2,000.

[¶ 10,265] Act Sec. 303. Law at ¶ 5041. CCH Explanation at ¶ 177.

Savings and Investment Incentives

Senate Committee Report

[*IRA early withdrawals*]

Individual retirement arrangements.—

In general.—The bill * * * (3) provides an exception from the early withdrawal tax for withdrawals for first-time home purchase (up to $10,000) and long-term unemployed individuals, * * *

Modifications to early withdrawal tax.—The bill provides that the 10-percent early withdrawal tax does not apply to withdrawals from an IRA (including an IRA Plus) for (1) up to $10,000 of first-time homebuyer expenses and (2) distributions for long-term unemployed individuals.[27]

Under the bill, qualified first-time homebuyer distributions are withdrawals of up to $10,000 during the individual's lifetime that are used within 120 days to pay costs (including reasonable settlement, financing, or other closing costs) of acquiring, constructing, or reconstructing the principal residence of a first-time homebuyer who is the individual, the individual's spouse, or a child, grandchild, or ancestor of the individual or individual's spouse. A first-time homebuyer is an

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[30] In the case of conversions from an IRA to an IRA Plus, the 5-taxable year holding period begins with the taxable year in which the conversion was made.

[51] For this purpose, AGI is determined before any amount includible in income as a result of the rollover or conversion.

[27] The bill also provides for penalty-free withdrawals from IRAs for education expenses (see above).

individual who has not had an ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the principal residence to which the withdrawal relates. The bill requires that the spouse of the individual also meet this requirement as of the date the contract is entered into or construction commences. The date of acquisition is the date the individual enters into a binding contract to purchase a principal residence or begins construction or reconstruction of such a residence. Principal residence is defined as under the provisions relating to the rollover of gain on the sale of a principal residence.

Under the bill, any amount withdrawn for the purchase of a principal residence is required to be used within 120 days of the date of withdrawal. The 10-percent additional income tax on early withdrawals is imposed with respect to any amount not so used. If the 120-day rule cannot be satisfied due to a delay in the acquisition of the residence, the taxpayer may recontribute all or part of the amount withdrawn to an IRA Plus prior to the end of the 120-day period without adverse tax consequences.

Under the bill, the 10-percent early withdrawal tax does not apply to distributions to an individual after separation form employment if the individual has received unemployment compensation for 12 consecutive weeks under any Federal or State unemployment compensation law and the distribution is made during any taxable year during which the unemployment compensation is paid or the succeeding taxable year. This exception does not apply to any distribution made after the individual has been employed for at least 60 days after the separation of employment. To the extent provided in regulations, the provision applies to a self-employed individual if, under Federal or State law, the individual would have received unemployment compensation but for the fact the individual was self employed.

* * *

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment but does not include the provision relating to long-term unemployed individuals.[52]

[¶ 10,270] Act Sec. 304. Law at ¶ 5139. CCH Explanation at ¶ 180.

Savings and Investment Incentives

Conference Committee Report

[*IRA investments in coins and bullion*]

Senate [Floor] Amendment.—IRA assets may be invested in certain platinum coins and in certain gold, silver, platinum or palladium bullion.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Agreement.—The conference agreement follows the Senate amendment.

[¶ 10,295] Act Sec. 311. Law at ¶ 5001, 5029, 5033, 5287, 5407, 5741 and 7005. CCH Explanation at ¶ 301, 302 and 303.

Savings and Investment Tax Incentives—Capital Gains

House Committee Report (Code and Related Non-Code Provisions)

[*Capital gains rate for individuals*]

Maximum rate of tax on net capital gain of individuals.—Under the bill, the maximum rate of tax on the net capital gain of an individual is reduced from 28 percent to 20 percent. In addition, any net capital gain which otherwise would be taxed at a 15 percent rate is taxed at a rate of 10 percent. These rates apply for purposes of both the regular tax and the minimum tax.

The tax on the net capital gain attributable to any long-term capital gain from the sale or exchange of collectibles will remain at a maximum rate of 28 percent; any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) to the extent the gain would have been treated as ordinary income if the property had been section 1245 property will be taxed at a maximum rate of 26 percent; and the tax treatment of small business stock (as defined in section 1202(c)) will remain unchanged. Gain from the disposition of a collectible which is an indexed asset (described below) will not be eligible for the 28-percent rate unless the taxpayer elects to forego indexing.

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[52] As under the House bill and Senate amendment, the conference agreement includes a penalty-free withdrawal provision for education expenses.

Effective date.—The provision applies to taxable years ending after May 6, 1997.

For a taxpayer's year that includes May 7, 1997, the lower rates will not apply to an amount equal the net capital gain determined by including only gain or loss properly taken into account for the portion of the taxable year before May 7, 1997. Any net capital gain not eligible for the lower rates will be subject to the present-law maximum rate of 28 percent. This generally has the effect of applying the lower rates to capital assets sold or exchanged (or installment payments received) on or after May 7, 1997, and subjecting the remaining portion of the net capital gain to a maximum rate of 28 percent.

In the case of gain taken into account by a pass-through entity (i.e., a RIC, a REIT, a partnership, an estate or trust, or a common trust fund), the date taken into account by the entity is the appropriate date for applying the rule in the preceding paragraph. Thus, gain taken into account by a pass-through entity before May 7, 1997 is not eligible for the lower rates.

* * *

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill except the maximum rate on gain attributable to the depreciation of section 1250 property is 24 percent (rather than 26 percent). * * *

Effective date.—The effective date is the same as the House bill.

Conference Agreement.—The conference agreement generally follows the House bill and the Senate amendment. The maximum rate of tax on gain attributable to the depreciation of section 1250 property will be 25 percent.

In addition, for taxable years beginning after December 31, 2000, the maximum capital gains rates for assets which are held more than 5 years, are 8 percent and 18 percent (rather than 10 percent and 20 percent). The 18-percent rate only applies to assets the holding period for which begins after December 31, 2000. A taxpayer holding a capital asset or asset used in the taxpayer's trade or business on January 1, 2001, may elect to treat the asset as having been sold on such date for an amount equal to its fair market value, and as having been reacquired for an amount equal to such value. If the election is made, any gain is recognized (and any loss disallowed). The conference agreement allows the Treasury Department to issue regulations coordinating the capital gain provisions with other rules involving the treatment of sales and exchanges by pass-thru entities and of interests therein.

Under the conference agreement, the lower capital gains rates do not apply to the sale or exchange of assets held for 18 months or less, effective for amounts properly taken into account after July 28, 1997. The 28-percent maximum rate will continue to apply to the sale or exchange of capital assets held more than 1 year but not more than 18 months.

[¶ 10,315] Act Sec. 312(a), (b) and (d). Law at ¶ 5007, 5015, 5031, 5049, 5061, 5069, 5083, 5107, 5165, 5173, 5317, 5321, 5323, 5329, 5343, 5353, 5361, 5575, 5599, 5621, 5665, 5679 and 5751. CCH Explanation at ¶ 129.

Savings and Investment Tax Incentives—Capital Gains

House Committee Report

[*Sale of principal residence*]

Exclusion of gain on sale of principal residence.—Under the bill a taxpayer generally is able to exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. The exclusion is allowed each time a taxpayer selling or exchanging a principal residence meets the eligibility requirements, but generally no more frequently than once every two years. The bill provides that gain would be recognized to the extent of any depreciation allowable with respect to the rental or business use of such principal residence for periods after May 6, 1997.

To be eligible for the exclusion, a taxpayer must have owned the residence and occupied it as a principal residence for at least two of the five years prior to the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or other unforseen circumstances is able to exclude the fraction of the $250,000 ($500,000 if married filing a joint return) equal to the fraction of two years that these requirements are met.

In the case of joint filers not sharing a principal residence, an exclusion of $250,000 is available on a qualifying sale or exchange of the principal residence of one of the spouses. Similarly, if a single taxpayer who is otherwise eligible for an exclusion marries someone who has used the exclusion within the two years prior to the marriage, the bill would allow the newly married taxpayer a maximum exclusion of $250,000. Once both spouses satisfy the eligibility rules and two years have passed since the last exclusion was allowed

to either of them, the taxpayers may exclude $500,000 of gain on their joint return.

Under the proposal, the gain from the sale or exchange of the remainder interest in the taxpayer's principal residence may qualify for the otherwise allowable exclusion.

Effective date.—The provision is available for all sales or exchanges of a principal residence occurring on or after May 7, 1997, and replaces the present-law rollover and one-time exclusion provisions applicable to principal residences.

A taxpayer could elect to apply present law (rather than the new exclusion) to a sale or exchange (1) made before the date of enactment of the Act, (2) made after the date of enactment pursuant to a binding contract in effect on the date or (3) where the replacement residence was acquired on or before the date of enactment (or pursuant to a binding contract in effect of the date of enactment) and the rollover provision would apply. If a taxpayer acquired his or her current residence in a rollover transaction, periods of ownership and use of the prior residence would be taken into account in determining ownership and use of the current residence.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill with technical modifications.

Conference Agreement.—The conference agreement generally follows the House bill and the Senate amendment.

The conferees wish to clarify that the provision limiting the exclusion to only one sale every two years by the taxpayer does not prevent a husband and wife filing a joint return from each excluding up to $250,000 of gain from the sale or exchange of each spouse's principal residence provided that each spouse would be permitted to exclude up to $250,000 of gain if they filed separate returns.

[¶ 10,317] Act Sec. 312(c). Law at ¶ 5599. CCH Explanation at ¶ 129 and 1050.

Other Miscellaneous Provisions

House Committee Report

[*Real estate transaction reporting*]

Information returns on real estate transactions.—The bill excludes sales of personal residences with a gross sales price of $500,000 or less ($250,000 or less in the case of a seller who is not married) from the real estate transaction reporting requirement. In order to be eligible for this exclusion, the person who would otherwise be required to file the informational return must obtain written assurances from the seller of the real estate, in a form acceptable to the Secretary of the Treasury, that any gain will be exempt from Federal income tax under section 121(a) and that no financing of the seller was federally-subsidized indebtedness.

Effective date.—The provision is effective for informational returns otherwise required to be filed with regard to real estate sales occurring after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment follows the House bill, with two modifications.

First, the requirement that the person who would otherwise be required to file the information return obtain written assurances that no financing of the seller was federally-subsidized indebtedness does not apply until such time as the Secretary of the Treasury requires this information to be included in information returns reporting real estate transactions.

Second, the Senate amendment does not exclude from the information reporting requirement any sale of a personal residence in the District of Columbia, if such sale is required to be reported for the purpose of verifying eligibility for the D.C. first-time homeowner credit. The Senate amendment separately establishes a credit of $5,000 for first-time home buyers in the District of Columbia. The Senate amendment anticipates that the Secretary of the Treasury will require such information as is necessary to verify eligibility for the D.C. first-time home buyer credit.

Effective date.—Same as the House bill.

Conference Agreement.—The conference agreement follows the Senate amendment with one modification, allowing the Secretary of the Treasury the discretion to increase the dollar threshholds if he determines that such an increase will not materially reduce revenues to the Treasury.

[¶ 10,320] Act Sec. 313. Law at ¶ 5317, 5333 and 5343. CCH Explanation at ¶ 306.

Savings and Investment Tax Incentives—Capital Gains

House Committee Report

[*Capital gains rate for individuals*]

Maximum rate of tax on net capital gain of individuals.—

* * * the tax treatment of small business stock (as defined in section 1202(c)) will remain unchanged. * * *

Effective date.—The provision applies to taxable years ending after May 6, 1997.

For a taxpayer's year that includes May 7, 1997, the lower rates will not apply to an amount equal the net capital gain determined by including only gain or loss properly taken into account for the portion of the taxable year before May 7, 1997. Any net capital gain not eligible for the lower rates will be subject to the present-law maximum rate of 28 percent. This generally has the effect of applying the lower rates to capital assets sold or exchanged (or installment payments received) on or after May 7, 1997, and subjecting the remaining portion of the net capital gain to a maximum rate of 28 percent.

In the case of gain taken into account by a pass-through entity (i.e., a RIC, a REIT, a partnership, an estate or trust, or a common trust fund), the date taken into account by the entity is the appropriate date for applying the rule in the preceding paragraph. Thus, gain taken into account by a pass-through entity before May 7, 1997 is not eligible for the lower rates.

* * *

Senate Committee Report

Small business stock.—Under the bill, the 50-percent exclusion will apply to small business stock (other than stock of a subsidiary corporation) held by a corporation. The minimum tax preference is repealed. Under the bill, in the case of a qualifying sale of small business stock by an individual, the maximum rate of tax (taking together the 50-percent exclusion and the maximum 20-percent capital gains rate added by the bill) will be 10 percent.

The bill increases the size of an eligible corporation from gross assets of $50 million to gross assets of $100 million. The bill also repeals the limitation on the amount of gain a taxpayer can exclude with respect to the stock of any corporation.

The bill provides that certain working capital must be expended within five years (rather than two years) in order to be treated as used in the active conduct of a trade or business. No limit on the percent of the corporation's assets that are working capital is imposed.

The bill provides that if the corporation establishes a business purpose for a redemption of its stock, that redemption is disregarded in determining whether other newly issued stock could qualify as eligible stock.

The bill allows a taxpayer to roll over gain from the sale or exchange of small business stock otherwise qualifying for the exclusion where the taxpayer uses the proceeds to purchase other qualifying small business stock within 60 days of the sale of the original stock. If the taxpayer sells the replacement stock, the gain attributable to the original stock is eligible for the small business stock exclusion and the capital gain rates, and any remaining gain is eligible for the capital gain rates if held more than one year and the small business exclusion if held for at least five years. In addition, any gain that otherwise would be recognized from the sale of the replacement stock can be rolled over to other small business stock purchased within 60 days.

Effective date.—The increase in the size of corporations whose stock is eligible for the exclusion and the provisions applicable to corporate shareholders applies to stock issued after the date of the enactment of the proposal. The remaining provisions apply to stock issued after August 10, 1993 (the original effective date of the small business stock provision).

Conference Committee Report

The conference agreement follows the provisions in the House bill. The conference agreement reduces the minimum tax preference from one-half of the excluded gain to 42 percent of such gain.

In addition, the conference agreement allows an individual to roll over tax-free gain from the sale or exchange of qualified small business stock held more than 6 months where the taxpayer uses the proceeds to purchase other qualified small business stock within 60 days of the sale. For purposes of the rollover provision, the replacement stock must meet the active business requirement for the 6-month period following the purchase. Generally, the holding period of the stock purchased will include the holding period of the stock sold, except for purposes of determining whether the 6-month holding period is met. The provision applies to sales after the date of enactment of this Act.

[¶ 10,325] Act Sec. 314. Law at ¶ 5341. CCH Explanation at ¶ 305.

Savings and Investment Tax Incentives—Capital Gains

House Committee Report

[*Alternative tax for corporations*]

30-percent corporate alternative tax for certain capital gains.—The bill provides an maximum rate of tax on the net capital gain of a corporation to the extent the gain is attributable to the sale or exchange of property held more than 8 years. The alternative tax is 32 percent on gain attributable to calendar year 1998; 31 percent on gain attributable to calendar year 1999; and 30 percent on gain attributable to calendar years after 1999. The bill also modifies the application of the corporate alternative capital gains tax so that the alternative capital gains tax applies to the lesser of 8-year gain or taxable income. Gain from the disposition of a collectible or attributable to the depreciation of section 1250 property is not eligible for the lower rate.

Effective date.—The provision applies to taxable years ending after December 31, 1997. However, the lower rate does not apply to amounts properly taken into account before January 1, 1998. For fiscal years beginning in 1998 and 1999, the tax is computed by applying the applicable percentage to the 8-year gain for the first portion of the year (or, if less, the 8-year gain for the entire year), but in an amount not to exceed the taxable income for the entire year and then by applying the applicable percentage to an amount equal to the 8-year gain for the entire year (or, if less, taxable income) reduced by the amount taxed at the applicable percentage for the first portion of the year.

In the case of gain taken into account by a corporation from a pass-through entity (i.e., a RIC, a REIT, an S corporation, a partnership, an estate or trust, or a common trust fund), the date taken into account by the entity is the appropriate date for applying the rule in the preceding paragraph.

Conference Committee Report

Senate Amendment.—No provision.

Conference Agreement.—The conference agreement does not include the House bill provision.

The conference agreement provides that the amount of gain subject to the alternative rate of tax under section 1201(a)(2) may not exceed the corporation's taxable income. Because the section 1201 alternative tax does not presently apply, this change has no effect under the rate structure of present law.

[¶ 10,335] Act Sec. 401. Law at ¶ 5029. CCH Explanation at ¶ 525.

Alternative Minimum Tax Provisions

House Committee Report

[*AMT for small businesses*]

Repeal alternative minimum tax for small businesses and repeal the depreciation adjustment.—

Repeal of the corporate alternative minimum tax for small businesses.—The corporate alternative minimum tax is repealed for small business corporations for taxable years beginning after December 31, 1997. A corporation that had average gross receipts of less than $5 million for the three-year period beginning after December 31, 1994, is a small business corporation for any taxable year beginning after December 31, 1997. A corporation that meets the $5 million gross receipts test will continue to be treated as small business corporation exempt from the alternative minimum tax so long as its average gross receipts do not exceed $7.5 million. A corporation that fails to meet the $7.5 million gross receipts test will become subject to corporate alternative minimum tax only with respect to preferences and adjustments that relate to transactions and investments entered into after the corporation loses its status as a small business corporation.

In addition, the alternative minimum tax credit allowable to a small business corporation may not exceed the corporation's regular tax liability (reduced by other credits) over 25 percent of the corporation's regular tax (reduced by foreign tax credits) in excess of $25,000.

* * *

Effective date.—Except as provided above, the provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—No provision.

Conference Agreement.—The conference agreement generally follows the House bill with respect to the repeal of the corporate alternative minimum tax for small businesses. * * *

[¶ 10,340] Act Sec. 402. Law at ¶ 5031. CCH Explanation at ¶ 527.

Alternative Minimum Tax Provisions

House Committee Report

[*Depreciation adjustment*]

* * *

Repeal of the depreciation adjustment.—The alternative minimum tax adjustment relating to depreciation is repealed for all taxpayers for property placed in service after December 31, 1998.

Effective date.—Except as provided above, the provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement generally follows the House bill * * *. In addition, for property (including pollution control facilities) placed in service after December 31, 1998, the conference agreement conforms the recovery periods used for purposes of the alternative minimum tax depreciation adjustment to the recovery periods used for purposes of the regular tax under present law.

[¶ 10,345] Act Sec. 403. Law at ¶ 5031. CCH Explanation at ¶ 363.

Alternative Minimum Tax Provisions

Conference Committee Report

[*Installment method adjustment: Farmers*]

Repeal installment method adjustment for farmers.—

House Bill.—The House bill generally provides that for purposes of the alternative minimum tax, farmers may use the installment method of accounting.

Effective date.—The provision generally is effective for dispositions in taxable years beginning after December 31, 1987, with a special rule for dispositions occurring in 1987.

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 10,365] Act Sec. 501(a) and (f). Law at ¶ 5417, 5419, 5439, 5455 and 5577. CCH Explanation at ¶ 201.

Estate and Gift Tax Provisions

House Committee Report

[*Unified credit*]

Increase in estate and gift tax unified credit.—The bill increases the present-law unified credit beginning in 1998, from an effective exemption of $600,000 to an effective exemption of $1,000,000 in 2007. The increase in the effective exemption is phased in according to the following schedule: the effective exemption is $650,000 for decedents dying and gifts made in 1998; $750,000 in 1999; $765,000 in 2000; $775,000 in 2001 through 2004; $800,000 in 2005; $825,000 in 2006; $1 million in 2007. After 2007, the effective exemption is indexed annually for inflation. The indexed exemption amount is rounded to the next lowest multiple of $10,000.

Conforming amendments to reflect the increased unified credit are made (1) to the 5-percent surtax to conform the phase out of the increased unified credit and graduated rates, (2) to the general filing requirements for an estate tax return under section 6018(a), and (3) to the amount of the unified credit allowed under section 2102(c)(3) with respect to nonresident aliens with U.S. situs property who are residents of certain treaty countries.

Effective date.—The provision is effective for decedents dying, and gifts made, after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment increases the present-law unified credit beginning in 1998, from an effective exemption of $600,000 to an effective exemption of $1,000,000 in 2006. The increase in the effective exemption is phased in according to the following schedule: the effective exemption is $625,000 for decedents dying and gifts made in 1998; $640,000 in 1999; $660,000 in 2000; $675,000 in 2001; $725,000 in 2002; $750,000 in 2003; $800,000 in 2004; $900,000 in 2005; and $1 million in 2006. After 2006, the effective exemption is indexed annually for inflation. The indexed exemption amount is rounded to the next lowest multiple of $10,000.

The Senate amendment includes the same conforming amendments as were made in the House bill.

Effective date.—The provision is effective for decedents dying, and gifts made, after December 31, 1997.

Conference Agreement.—The conference agreement increases the present-law unified credit beginning in 1998, from an effective exemption of $600,000 to an effective exemption of $1,000,000 in 2006. The increase in the effective exemption is phased in according to the following schedule: the effective exemption is $625,000 for decedents dying and gifts made in 1998; $650,000 in 1999; $675,000 in 2000 and 2001; $700,000 in 2002 and 2003; $850,000 in 2004; $950,000 in 2005; and $1 million in 2006 and thereafter. The conference does not index the effective exemption for inflation.

The conference agreement includes the conforming amendments made in the House bill and the Senate amendment.

Effective date.—The provision is effective for decedents dying, and gifts made, after December 31, 1997.

[¶ 10,370] Act Sec. 501(b), (c), (d), (e) and (f). Law at ¶ 5425, 5451, 5461 and 5685. CCH Explanation at ¶ 204.

Estate and Gift Tax Provisions

House Committee Report

[*Indexing*]

Indexing of certain other estate and gift tax provisions.—The bill provides that, after 1998, the $10,000 annual exclusion for gifts, the $750,000 ceiling on special use valuation, the $1,000,000 generation-skipping transfer tax exemption, and the $1,000,000 ceiling on the value of a closely-held business eligible for the special low interest rate (as modified below), are indexed annually for inflation. Indexing of the annual exclusion is rounded to the next lowest multiple of $1,000 and indexing of the other amounts is rounded to the next lowest multiple of $10,000.

Effective date.—The proposal is effective for decedents dying, and gifts made, after December 31, 1998.

Conference Committee Report

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

[¶ 10,375] Act Sec. 502. Law at ¶ 5427. CCH Explanation at ¶ 215.

Estate, Gift, and Generation-Skipping Tax Provisions

Senate Committee Report

[*Estate tax : Exclusion for family-owned businesses*]

Estate tax exclusions for qualified family-owned businesses.—The bill allows an executor to elect special estate tax treatment for qualified "family-owned business interests" if such interests comprise more than 50 percent of a decedent's estate and certain other requirements are met.

In general, the provision excludes the first $1 million of value in qualified family-owned business interests from a decedent's taxable estate.

This new exclusion for qualified family-owned business interests is provided in addition to the unified credit (which presently effectively exempts $600,000 of taxable transfers from the estate and gift tax, and will be increased to an effective exemption of $1,000,000 of taxable transfers under other provisions of the bill), the special-use provisions of section 2032A (which permit the exclusion of up to $750,000 in value of a qualifying farm or other closely-held business from a decedent's estate), and the provisions of section 6166 (which provide for the installment payment of estate taxes attributable to closely held businesses).

Qualified family-owned business interests.—For purposes of the bill, a qualified family-owned business interest is defined as any interest in a trade or business (regardless of the form in which it is held) with a principal place of business in the United States if ownership of the trade or business is held at least 50 percent by one family, 70 percent by two families, or 90 percent by three families, as long as the decedent's family owns at least 30 percent of the trade or business. Under the provision, members of an individual's family are defined using the same definition as is used for the special-use valuation rules of section 2032A, and thus include (1) the individual's spouse, (2) the individual's ancestors, (3) lineal descendants of the individual, of the individual's spouse, or of the individual's parents, and (4) the spouses of any such lineal descendants. For purposes of applying the ownership tests in the case of a corporation, the decedent and members of the decedent's family are required to own the requisite percentage of the total combined voting power of all classes of stock entitled to vote *and* the requisite percentage of the total value of all shares of all classes of stock of the corporation. In the case of a partnership, the decedent and members of the decedent's family are required to own the requisite percentage of the capital interest, and the requisite percentage of the profits interest, in the partnership.

In the case of a trade or business that owns an interest in another trade or business (i.e., "tiered entities"), special look-through rules apply. Each trade or business owned (directly or indirectly) by the decedent and members of the decedent's family is separately tested to determine whether that trade or business meets the requirements of a qualified family-owned business interest. In applying these tests, any interest that a trade or business owns in another trade or business is disregarded in determining whether the first trade or business is a qualified family-owned business interest. The value of any qualified family-owned business interest held by an entity is treated as being proportionately owned by or for the entity's partners, shareholders, or beneficiaries. In the case of a multi-tiered entity, such rules are sequentially applied to look through each separate tier of the entity.

For example, if a holding company owns interests in two other companies, each of the three entities will be separately tested under the qualified family-owned business interest rules. In determining whether the holding company is a qualified family-owned business interest, its ownership interest in the other two companies is disregarded. Even if the holding company itself does not qualify as a family-owned business interest, the other two companies still may qualify if the direct and indirect interests held by the decedent and his or her family members satisfy the requisite ownership percentages and other requirements of a qualified family-owned business interest. If either (or both) of the lower-tier entities qualify, the value of the qualified family-owned business interests owned by the holding company are treated as proportionately owned by the holding company's shareholders.

An interest in a trade or business does not qualify if the business's (or a related entity's) stock or securities were publicly-traded at any time within three years of the decedent's death. An interest in a trade or business also does not qualify if more than 35 percent of the adjusted ordinary gross income of the business for the year of the decedent's death was personal holding company income (as defined in section 543). This personal holding company restriction does not apply to banks or domestic building and loan associations.

The value of a trade or business qualifying as a family-owned business interest is reduced to the extent the business holds passive assets or excess cash or marketable securities. Under the bill, the value of qualified family-owned business interests does not include any cash or marketable securities in excess of the reasonably expected day-to-day working capital needs of the trade or business. For this purpose, it is intended that day-to-day working capital needs be determined based on a historical average of the business's working capital needs in the past, using an analysis similar to that set forth in *Bardahl Mfg. Corp.*, 24 T.C.M. 1030 (1965). It is further intended that accumulations for capital acquisitions not be considered "working capital" for this purpose. The value of the qualified family-owned business interests also does not include certain other passive assets. For this purpose, passive assets include any assets that (a) produce dividends, interest, rents, royalties, annuities and certain other types of passive income (as described in sec. 543(a)); (b) are an interest in a trust, partnership or REMIC (as described in sec. 954(c)(1)(B)(ii)); (c) produce no income (as described in sec. 954(c)(1)(B)(iii)); (d) give rise to income from commodities transactions or foreign currency gains (as described in sec. 954(c)(1)(C) and (D)); (e) produce income equivalent to interest (as described in sec. 954(c)(1)(E)); or (f) produce income from notional principal contracts or payments in lieu of dividends (as described in new secs. 954(c)(1)(F) and (G), added elsewhere in the bill). In the case of a regular dealer in property, such property is not considered to produce passive income under these rules, and thus, is not considered to be a passive asset.

Qualifying estates.—A decedent's estate qualifies for the special treatment only if the decedent was a U.S. citizen or resident at the time of death, and the aggregate value of the decedent's qualified family-owned business interests that are

passed to qualified heirs exceeds 50 percent of the decedent's adjusted gross estate (the "50-percent liquidity test"). For this purpose, qualified heirs include any individual who has been actively employed by the trade or business for at least 10 years prior to the date of the decedent's death, and members of the decedent's family. If a qualified heir is not a citizen of the United States, any qualified family-owned business interest acquired by that heir must be held in a trust meeting requirements similar to those imposed on qualified domestic trusts (under present-law sec. 2056A(a)), or through certain other security arrangements that meet the satisfaction of the Secretary. The 50-percent liquidity test generally is applied by adding all transfers of qualified family-owned business interests made by the decedent to qualified heirs at the time of the decedent's death, plus certain lifetime gifts of qualified family-owned business interests made to members of the decedent's family, and comparing this total to the decedent's adjusted gross estate. To the extent that a decedent held qualified family-owned business interests in more than one trade or business, all such interests are aggregated for purposes of applying the 50-percent liquidity test.

The 50-percent liquidity test is calculated using a ratio, the numerator and denominator of which are described below.

The numerator is determined by aggregating the value of all qualified family-owned business interests that are includible in the decedent's gross estate and are passed from the decedent to a qualified heir, plus any lifetime transfers of qualified business interests that are made by the decedent to members of the decedent's family (other than the decedent's spouse), provided such interests have been continuously held by members of the decedent's family and were not otherwise includible in the decedent's gross estate. For this purpose, qualified business interests transferred to members of the decedent's family during the decedent's lifetime are valued as of the date of such transfer. This amount is then reduced by all indebtedness of the estate, except for the following: (a) indebtedness on a qualified residence of the decedent (determined in accordance with the requirements for deductibility of mortgage interest set forth in section 163(h)(3)); (b) indebtedness incurred to pay the educational or medical expenses of the decedent, the decedent's spouse or the decedent's dependents; (c) other indebtedness of up to $10,000.

The denominator is equal to the decedent's gross estate, reduced by any indebtedness of the estate, and increased by the amount of the following transfers, to the extent not already included in the decedent's gross estate: (a) any lifetime transfers of qualified business interests that were made by the decedent to members of the decedent's family (other than the decedent's spouse), provided such interests have been continuously held by members of the decedent's family, plus (b) any other transfers from the decedent to the decedent's spouse that were made within 10 years of the date of the decedent's death, plus (c) any other transfers made by the decedent within three years of the decedent's death, except non-taxable transfers made to members of the decedent's family. The Secretary of Treasury is granted authority to disregard de minimis gifts. In determining the amount of gifts made by the decedent, any gift that the donor and the donor's spouse elected to have treated as a split gift (pursuant to sec. 2513) is treated as made one-half by each spouse for purposes of this provision.

Participation requirements.—To qualify for the beneficial treatment provided under the bill, the decedent (or a member of the decedent's family) must have owned and materially participated in the trade or business for at least five of the eight years preceding the decedent's date of death. In addition, each qualified heir (or a member of the qualified heir's family) is required to materially participate in the trade or business for at least five years of any eight-year period within ten years following the decedent's death. For this purpose, "material participation" is defined as under present-law section 2032A (special use valuation) and the regulations promulgated thereunder. See, e.g., Treas. Reg. sec. 20.2032A-3. Under such regulations, no one factor is determinative of the presence of material participation and the uniqueness of the particular industry (e.g., timber, farming, manufacturing, etc.) must be considered. Physical work and participation in management decisions are the principal factors to be considered. For example, an individual generally is considered to be materially participating in the business if he or she personally manages the business fully, regardless of the number of hours worked, as long as any necessary functions are performed.

If a qualified heir rents qualifying property to a member of the qualified heir's family on a net cash basis, and that family member materially participates in the business, the material participation requirement will be considered to have been met with respect to the qualified heir for purposes of this provision.

Recapture provisions.—The benefit of the exclusions for qualified family-owned business interests are subject to recapture if, within 10 years of the decedent's death and before the qualified heir's death, one of the following "recapture events" occurs: (1) the qualified heir ceases to meet the material participation requirements (i.e., if neither the qualified heir nor any member of his or her family has materially participated in the trade or business for at least five years of any eight-year period); (2) the qualified heir disposes of any portion of his or her interest in the family-

owned business, other than by a disposition to a member of the qualified heir's family or through a conservation contribution under section 170(h); (3) the principal place of business of the trade or business ceases to be located in the United States; or (4) the qualified heir loses U.S. citizenship. A qualified heir who loses U.S. citizenship may avoid such recapture by placing the qualified family-owned business assets into a trust meeting requirements similar to a qualified domestic trust (as described in present law section 2056A(a)), or through certain other security arrangements.

If one of the above recapture events occurs, an additional tax is imposed on the date of such event. As under section 2032A, each qualified heir is personally liable for the portion of the recapture tax that is imposed with respect to his or her interest in the qualified family-owned business. Thus, for example, if a brother and sister inherit a qualified family-owned business from their father, and only the sister materially participates in the business, her participation will cause both her and her brother to meet the material participation test. If she ceases to materially participate in the business within 10 years after her father's death (and the brother still does not materially participate), the sister and brother would both be liable for the recapture tax; that is, each would be liable for the recapture tax attributable to his or her interest.

The portion of the reduction in estate taxes that is recaptured would be dependent upon the number of years that the qualified heir (or members of the qualified heir's family) materially participated in the trade or business after the decedent's death. If the qualified heir (or his or her family members) materially participated in the trade or business after the decedent's death for less than six years, 100 percent of the reduction in estate taxes attributable to that heir's interest is recaptured; if the participation was for at least six years but less than seven years, 80 percent of the reduction in estate taxes is recaptured; if the participation was for at least seven years but less than eight years, 60 percent is recaptured; if the participation was for at least eight years but less than nine years, 40 percent is recaptured; and if the participation was for at least nine years but less than ten years, 20 percent of the reduction in estates taxes is recaptured. In general, there is no requirement that the qualified heir (or members of his or her family) continue to hold or participate in the trade or business more than 10 years after the decedent's death. As under present-law section 2032A, however, the 10-year recapture period may be extended for a period of up to two years if the qualified heir does not begin to use the property for a period of up to two years after the decedent's death.

If a recapture event occurs with respect to any qualified family-owned business interest (or portion thereof), the amount of reduction in estate taxes attributable to that interest is determined on a proportionate basis. For example, if the decedent's estate included $2 million in qualified family-owned business interests and $1 million of such interests received beneficial treatment under this proposal, one-half of the value of the interest disposed of is deemed to have received the benefits provided under this proposal.

Effective date.—The provision is effective with respect to the estates of decedents dying after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment, except that the exclusion for family-owned business interests may be taken only to the extent that the exclusion for family-owned business interests, plus the amount effectively exempted by the unified credit, does not exceed $1.3 million.

The conferees clarify that a sale or disposition, in the ordinary course of business, of assets such as inventory or a piece of equipment used in the business (e.g., the sale of crops or a tractor) would not result in recapture of the benefits of the qualified family-owned business exclusion.

[¶ 10,380] Act Sec. 503. Law at ¶ 5069, 5431, 5617 and 5685. CCH Explanation at ¶ 227.

Estate and Gift Tax Provisions

House Committee Report

[*Interest on deferred estate tax*]

Installment payments of estate tax attributable to closely held businesses.—

* * *

In addition, the bill provides that no interest is imposed on the amount of deferred estate tax attributable to the first $1,000,000 in *taxable* value of the closely held business (i.e., the first $1,000,000 in value in excess of the effective exemption provided by the unified credit). Thus, for example, in 1998, when the unified credit is increased to provide an effective exemption of $650,000 (as described above), the amount of estate tax attributable to the value of the closely held business between $650,000 and $1,650,000 is eligible for the zero-percent interest rate.

The interest rate imposed on the amount of deferred estate tax attributable to the taxable value of the closely held business in excess of $1,000,000 is reduced to an amount equal to 45 percent of the rate applicable to underpayments of tax. The interest paid on estate taxes deferred under section 6166 is not deductible for estate or income tax purposes.

Effective date.—The provision is effective for decedents dying after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement reduces the 4-percent interest rate to 2 percent, and makes the interest paid on estate taxes deferred under section 6166 non-deductible for estate or income tax purposes. The 2-percent interest rate is imposed on the amount of deferred estate tax attributable to the first $1,000,000 in *taxable* value of the closely held business (i.e., the first $1,000,000 in value in excess of the effective exemption provided by the unified credit and any other exclusions).[55] The interest rate imposed on the amount of deferred estate tax attributable to the taxable value of the closely held business in excess of $1,000,000 is reduced to an amount equal to 45 percent of the rate applicable to underpayments of tax.

The conference agreement does not include the provision that extends the repayment period to a maximum period of 24 years or the provision that provides a zero-percent interest rate for a portion of the deferred estate tax attributable to closely held businesses.

Effective date.—The provision is effective for decedents dying after December 31, 1997. Estates deferring estate tax under current law may make a one-time election to use the lower interest rates and forego the interest deduction for installments due after the date of the election (but such estates do not receive the benefit of the increase in the amount eligible for the 6601(j) interest rate—i.e., only the amount that was previously eligible for the 4-percent rate would be eligible for the 2-percent rate).

[¶ 10,385] Act Sec. 504. Law at ¶ 5425. CCH Explanation at ¶ 229.

Estate and Gift Tax Provisions

House Committee Report

[*Cash leases of specially-valued property*]

Estate tax recapture from cash leases of specially-valued property.—The bill provides that the cash lease of specially-valued real property by a lineal descendant of the decedent to a member of the lineal descendant's family, who continues to operate the farm or closely held business, does not cause the qualified use of such property to cease for purposes of imposing the additional estate tax under section 2032A(c).

Effective date.—The provision is effective for cash rentals occurring after December 31, 1976.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 10,390] Act Sec. 505. Law at ¶ 5731. CCH Explanation at ¶ 225.

Estate and Gift Tax Provisions

House Committee Report

[*Extension of time to pay estate tax*]

Clarify eligibility for extension of time for payment of estate tax.—The provision authorizes the U.S. Tax Court to provide declaratory judgments regarding initial or continuing eligibility for deferral under section 6166.

Effective date.—The provision applies to decedents dying after date of enactment.

Conference Committee Report

The conference agreement follows the House bill.

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[55] The $1,000,000 threshold is indexed under other provisions of the bill.

[¶ 10,395] Act Sec. 506. Law at ¶ 5417, 5453, 5675 and 5729. CCH Explanation at ¶ 255.

Estate and Gift Tax Provisions

House Committee Report

[*Statute of limitations: Gifts*]

Gifts may not be revalued for estate tax purposes after expiration of statute of limitations expires.—The bill provides that a gift for which the limitations period has passed cannot be revalued for purposes of determining the applicable estate tax bracket and available unified credit. For gifts made in calendar years after the date of enactment, the bill also extends the special rule governing gifts valued under Chapter 14 to all gifts. Thus, the statute of limitations will not run on an inadequately disclosed transfer in calendar years after the date of enactment, regardless of whether a gift tax return was filed for other transfers in that same year.

It is intended that, in order to revalue a gift that has been adequately disclosed on a gift tax return, the IRS must issue a final notice of redetermination of value (a "final notice") within the statute of limitations applicable to the gift for gift tax purposes (generally, three years). This rule is applicable even where the value of the gift as shown on the return does not result in any gift tax being owed (e.g., through use of the unified credit). It is also anticipated that the IRS will develop an administrative appeals process whereby a taxpayer can challenge a redetermination of value by the IRS prior to issuance of a final notice.

A taxpayer who is mailed a final notice may challenge the redetermined value of the gift (as contained in the final notice) by filing a motion for a declaratory judgment with the Tax Court. The motion must be filed on or before 90 days from the date that the final notice was mailed. The statute of limitations is tolled during the pendency of the Tax Court proceeding.

Effective date.—The provision generally applies to gifts made after the date of enactment. The extension of the special rule under chapter 14 to all gifts applies to gifts made in calendar years after the date of enactment.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 10,415] Act Sec. 507. Law at ¶ 5195 and 5205. CCH Explanation at ¶ 275.

Estate and Gift Tax Provisions

House Committee Report

[*Throwback rules for domestic trusts*]

Repeal of throwback rules applicable to domestic trusts.—The bill exempts from the throwback rules amounts distributed by a domestic trust after the date of enactment. The provision also provides that precontribution gain on property sold by a domestic trust no longer is subject to section 644 (i.e., taxed at the contributor's marginal tax rates).

The treatment of foreign trusts, including the treatment of foreign trusts that become domestic trusts,[33] remains unchanged.

Effective date.—The provision with respect to the throwback rules is effective for distributions made in taxable years beginning after the date of enactment. The modification to section 644 applies to sales or exchanges after the date of enactment.

Conference Committee Report

The conference agreement follows the House bill, except that the throwback rules continue to apply with respect to (a) foreign trusts, (b) domestic trusts that were once treated as foreign trusts (except as provided in Treasury regulations), and (c) domestic trusts created before March 1, 1984, that would be treated as multiple trusts under sec. 643(f) of the Code.

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[33] Rev. Rul. 91-6, 1991-1 C.B. 89.

[¶ 10,420] Act Sec. 508. Law at ¶ 5077, 5315, 5423 and 5425. CCH Explanation at ¶ 214.

Estate, Gift, and Generation-Skipping Tax Provisions

Senate Committee Report

[*Permanent conservation easement*]

Reduction in estate taxes for certain land subject to permanent conservation easement.—The provision allows an executor to elect to exclude from the taxable estate 40 percent of the value of any land subject to a qualified conservation easement that meets the following requirements: (1) the land is located within 25 miles of a metropolitan area (as defined by the Office of Management and Budget) or a national park or wilderness area, or within 10 miles of an Urban National Forest (as designated by the Forest Service of the U.S. Department of Agriculture); (2) the land has been owned by the decedent or a member of the decedent's family at all times during the three-year period ending on the date of the decedent's death; and (3) a qualified conservation contribution (within the meaning of section 170(h)) of a qualified real property interest (as generally defined in section 170(h)(2)(C)) was granted by the transferor or a member of his or her family. For purposes of the provision, preservation of a historically important land area or a certified historic structure does not qualify as a conservation purpose. To the extent that the value of such land is excluded from the taxable estate, the basis of such land acquired at death is a carryover basis (i.e., the basis is not stepped-up to its fair market value at death). Debt-financed property is not eligible for the exclusion.

The exclusion amount is calculated based on the value of the property after the conservation easement has been placed on the property. The exclusion from estate taxes does not extend to the value of any development rights retained by the decedent or donor, although payment for estate taxes on retained development rights may be deferred for up to two years, or until the disposition of the property, whichever is earlier. For this purpose, retained development rights are any rights retained to use the land for any commercial purpose which is not subordinate to and directly supportive of farming purposes, as defined in section 6420 (e.g., tree farming, ranching, viticulture, and the raising of other agricultural or horticultural commodities).

Maximum benefit allowed.—The 40-percent estate tax exclusion for land subject to a qualified conservation easement (described above) may be taken only to the extent that the total exclusion for qualified conservation easements, plus the exclusion for qualified family-owned business interests (described in C., above), does not exceed $1 million. The executor of an estate holding land subject to a qualified conservation easement and/or qualified family-owned business interests is required to designate which of the two benefits is being claimed with respect to each property on which a benefit is claimed.

If the value of the conservation easement is less than 30 percent of (a) the value of the land without the easement, reduced by (b) the value of any retained development rights, then the exclusion percentage is reduced. The reduction in the exclusion percentage is equal to two percentage points for each point that the above ratio falls below 30 percent. Thus, for example, if the value of the easement is 25 percent of the value of the land before the easement less the value of the retained development rights, the exclusion percentage is 30 percent (i.e., the 40 percent amount is reduced by twice the difference between 30 percent and 25 percent). Under this calculation, if the value of the easement is 10 percent or less of the value of the land before the easement less the value of the retained development rights, the exclusion percentage is equal to zero.

Treatment of land subject to a conservation easement for purposes of special-use valuation.—The granting of a qualified conservation easement (as defined above) is not treated as a disposition triggering the recapture provisions of section 2032A. In addition, the existence of a qualified conservation easement does not prevent such property from subsequently qualifying for special-use valuation treatment under section 2032A.

Retained mineral interests.—The provision also allows a charitable deduction (for income tax purposes or estate tax purposes) to taxpayers making a contribution of a permanent conservation easement on property where a mineral interest has been retained and surface mining is possible, but its probability is "so remote as to be negligible." Present law provides for a charitable deduction in such a case if the mineral interests have been separated from the land prior to June 13, 1976. The provision allows such a charitable deduction to be taken regardless of when the mineral interests had been separated.

Effective date.—The estate tax exclusion applies to decedents dying after December 31, 1997. The rules with respect to the treatment of conservation easements under section 2032A and with respect to retained mineral interests are effective for easements granted after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment, except that the maximum exclusion for land subject to a qualified conservation easement is limited to $100,000 in 1998, $200,000 in 1999, $300,000 in 2000, $400,000 in 2001, and $500,000 in 2002 and thereafter. The exclusion for land subject to a qualified conservation easement may be taken in addition to the maximum exclusion for qualified family-owned business interests (i.e., there is no coordination between the two provisions).

The conference agreement provides that de minimis commercial recreational activity that is consistent with the conservation purpose, such as the granting of hunting and fishing licenses, will not cause the property to fail to qualify under this provision. It is anticipated that the Secretary of the Treasury will provide guidance as to the definition of "de minimis" activities. In addition, the conference agreement makes technical modifications (a) to provide that the definition of farming for purposes of this provision is the same as the definition set forth in section 2032A(e)(5), and (b) to clarify that a post-mortem conservation easement may be placed on the property, as long as the easement has been made no later than the date of the election.

The conferees clarify that debt-financed property is eligible for this provision to the extent of the net equity in the property. For example, if a $1 million property is subject to an outstanding debt balance of $100,000, it is treated in the same manner as a $900,000 property that is not debt-financed.

[¶ 10,425] Act Sec. 511. Law at ¶ 5459 and 5463. CCH Explanation at ¶ 249.

Generation-Skipping Tax Provisions

House Committee Report

[*Predeceased parent exception*]

Modification of generation-skipping transfer tax for transfers to individuals with deceased parents.—The bill extends the predeceased parent exception to transfers to collateral heirs, provided that the decedent has no living lineal descendants at the time of the transfer. For example, the exception would apply to a transfer made by an individual (with no living lineal heirs) to a grandniece where the transferor's nephew or niece who is the parent of the grandniece is deceased at the time of the transfer.

In addition, the bill extends the predeceased parent exception (as modified by the change in the preceding paragraph) to taxable terminations and taxable distributions, provided that the parent of the relevant beneficiary was dead at the earliest time that the transfer (from which the beneficiary's interest in the property was established) was subject to estate or gift tax. For example, where a trust was established to pay an annuity to a charity for a term for years with a remainder interest granted to a grandson, the termination of the term for years would not be a taxable termination subject to the GST tax if the grandson's parent (who is the son or daughter of the transferor) is deceased at the time the trust was created and the transfer creating the trust was subject to estate or gift tax.

Effective date.—The provision is effective for generation skipping transfers occurring after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 10,435] Act Sec. 601. Law at ¶ 5019 and 5021. CCH Explanation at ¶ 317.

Extension of Certain Expiring Tax Provisions

House Committee Report

[*Research tax credit*]

Research tax credit.—The research tax credit is extended for 19 months—i.e., generally for the period June 1, 1997, through December 31, 1998.

Under the provision, taxpayers are permitted to elect the alternative incremental research credit regime under section 41(c)(4) for any taxable year beginning after June 30, 1996, and such election will apply to that taxable year and all subsequent taxable years unless revoked with the consent of the Secretary of the Treasury.

Effective date.—The provision generally is effective for qualified research expenditures paid or incurred during the period June 1, 1997, through December 31, 1998.

A special rule provides that, notwithstanding the general termination date for the research credit of December 31, 1998, if a taxpayer elects

to be subject to the alternative incremental research credit regime for its first taxable year beginning after June 30, 1996, and before July 1, 1997, the alternative incremental research credit will be available during the entire 30-month period beginning with the first month of such taxable year—i.e., the equivalent of the 11-month extension provided for by the Small Business Job Protection Act of 1996 *plus* an additional 19-month extension provided for by this bill. However, to prevent taxpayers from effectively obtaining more than 30-months of research credits from the Small Business Job Protection Act of 1996 and this bill, the 30-month period for taxpayers electing the alternative incremental research credit regime is reduced by the number of months (if any) after June 1996 with respect to which the taxpayer claimed research credit amounts under the regular, 20-percent research credit rules.

Senate Committee Report

Research tax credit.—The research tax credit is extended for 31 months—i.e., generally for the period June 1, 1997, through December 31, 1999.

Under the provision, taxpayers are permitted to elect the alternative incremental research credit regime under section 41(c)(4) for any taxable year beginning after June 30, 1996, and such election will apply to that taxable year and all subsequent taxable years unless revoked with the consent of the Secretary of the Treasury.

Effective date.—The provision generally is effective for qualified research expenditures paid or incurred during the period June 1, 1997, through December 31, 1999.

A special rule provides that, notwithstanding the general termination date for the research credit of December 31, 1999, if a taxpayer elects to be subject to the alternative incremental research credit regime for its first taxable year beginning after June 30, 1996, and before July 1, 1997, the alternative incremental research credit will be available during the entire 42-month period beginning with the first month of such taxable year—i.e., the equivalent of the 11-month extension provided for by the Small Business Job Protection Act of 1996 *plus* an additional 31-month extension provided for by this bill. However, to prevent taxpayers from effectively obtaining more than 42-months of research credits from the Small Business Job Protection Act of 1996 and this bill, the 42-month period for taxpayers electing the alternative incremental research credit regime is reduced by the number of months (if any) after June 1996 with respect to which the taxpayer claimed research credit amounts under the regular, 20-percent research credit rules.

Conference Committee Report

Under the conference agreement, the research tax credit is extended for 13 months—i.e., generally for the period June 1, 1997, through June 30, 1998.

Under the provision, taxpayers are permitted to elect the alternative incremental research credit regime under section 41(c)(4) for any taxable year beginning after June 30, 1996, and such election will apply to that taxable year and all subsequent taxable years unless revoked with the consent of the Secretary of the Treasury.

Effective date.—The provision generally is effective for qualified research expenditures paid or incurred during the period June 1, 1997, through June 30, 1998. A special rule provides that, notwithstanding the general termination date for the research credit of June 30, 1998, if a taxpayer elects to be subject to the alternative incremental research credit regime for its first taxable year beginning after June 30, 1996, and before July 1, 1997, the alternative incremental research credit will be available during the entire 24-month period beginning with the first month of such taxable year—i.e., the equivalent of the 11-month extension provided for by the Small Business Job Protection Act of 1996 *plus* an additional 13-month extension provided for by the conference agreement. However, to prevent taxpayers from effectively obtaining more than 24-months of research credits from the Small Business Job Protection Act of 1996 and this bill, the 24-month period for taxpayers electing the alternative incremental research credit regime is reduced by the number of months (if any) after June 1996 with respect to which the taxpayer claimed research credit amounts under the regular, 20-percent research credit rules.

[¶ 10,440] Act Sec. 602. Law at ¶ 5077. CCH Explanation at ¶ 105.

Extension of Certain Expiring Tax Provisions

House Committee Report

[*Stock contributed to private foundations*]

Contributions of stock to private foundations.—The bill extends the special rule contained in section 170(e)(5) for contributions of qualified appreciated stock made to private foundations during the period June 1, 1997, through December 31, 1998.

Effective date.—The provision is effective for contributions of qualified appreciated stock to private foundations made during the period June 1, 1997, through December 31, 1998.

Senate Committee Report

Contributions of stock to private foundations.—The bill extends the special rule contained in section 170(e)(5) for contributions of qualified appreciated stock made to private foundations during the period June 1, 1997, through December 31, 1999.

Effective date.—The provision is effective for contributions of qualified appreciated stock to private foundations made during the period June 1, 1997, through December 31, 1999.

Conference Committee Report

The conference agreement provides that the special rule contained in section 170(e)(5) is extended for the period June 1, 1997, through June 30, 1998. The provision is effective for contributions of qualified appreciated stock to private foundations made during the period June 1, 1997, through June 30, 1998.

[¶ 10,445] Act Sec. 603. Law at ¶ 5023. CCH Explanation at ¶ 318.

Extension of Certain Expiring Tax Provisions

House Committee Report

[*Work opportunity tax credit*]

Work opportunity tax credit.—The bill extends for one year the work opportunity tax credit and makes four modifications: (1) the minimum employment period is reduced to 120 hours, (2) the credit percentage is modified so that the percentage is 25% for the first 400 hours and 40% thereafter (assuming the minimum employment period is satisfied with respect to that employee), (3) an otherwise eligible member of a family receiving AFDC benefits satisfies the credit requirements if the family has received AFDC benefits for any 9-month period during the 18-month period ending on the hiring date (this expansion applies whether or not the individual is a qualified veteran) * * *.

Effective date.—Generally the provisions that extend the work opportunity tax credit and make other modifications to the credit are effective for wages paid or incurred to qualified individuals who begin work for the employer after September 30, 1997, and before October 1, 1998. The provision allowing the credit against the AMT is effective for taxable years beginning after December 31, 1997.

Senate Committee Report

Work opportunity tax credit.—The bill extends for 22 months the work opportunity tax credit. The bill also modifies the credit in four additional ways. First, the bill modifies the eligibility definition for the AFDC families targeted group. Specifically, under the bill an otherwise eligible member of a family receiving AFDC benefits for any 9-month period (whether or not consecutive) during the 18-month period ending on the hiring date would qualify as a member of this targeted group (this expansion applies whether or not the individual is a qualified veteran). Second, the proposal adds another targeted group to the credit. The new targeted group is persons certified by the designated local agency as receiving certain Supplemental Security Income (SSI) benefits for any month ending within the 60 day period ending on the hiring date. For these purposes, SSI benefits would mean benefits under title XVI of the Social Security Act (including supplemental security income benefits of the type described in section 1616 of such Act or section 212 of Public Law 93-66). Third, the bill reduces the minimum employment period to 120 hours. Finally, the bill modifies the credit percentage so that it is 25% for the first 400 hours and 40% thereafter (assuming the minimum employment period is satisfied with respect to that employee.

Effective date.—The provisions to extend and modify the work opportunity tax credit are effective for wages paid or incurred to qualified individuals who begin work for the employer after September 30, 1997, and before August 1, 1999.

Conference Committee Report

Extension.—The conference agreement provides for a 9-month extension of the work opportunity tax credit.

Targeted categories.—The conference agreement follows the Senate amendment.

Minimum employment period.—The conference agreement follows the House bill and the Senate amendment.

Credit percentage.—The conference agreement follows the House bill and the Senate amendment.

* * *

Effective date.—The conference agreement is generally effective for wages paid to qualified individuals who begin work for an employer after September 30, 1997, and before July 1, 1998.

[¶ 10,450] Act Sec. 604. Law at ¶ 5021. CCH Explanation at ¶ 319.

Extension of Certain Expiring Tax Provisions

House Committee Report

[*Orphan drug tax credit*]

Orphan drug tax credit.—The orphan drug tax credit provided for by section 45C is permanently extended.

Effective date.—The provision is effective for qualified clinical testing expenses paid or incurred after May 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and Senate amendment—i.e., the orphan drug tax credit is permanently extended.

[¶ 10,465] Act Sec. 701. Law at ¶ 5017, 5317, 5395, 5397, 5399 and 5401. CCH Explanation at ¶ 381, 383, 385 and 387.

District of Columbia Tax Incentives

House Committee Report

[*Incentives for revitalizing D.C.*]

District of Columbia tax incentives.—

Designation of D.C. Enterprise Zone.—Certain economically depressed census tracts within the District of Columbia are designated as the "D.C. Enterprise Zone," within which businesses and individual residents are eligible for special tax incentives. The census tracts that compose the D.C. Enterprise Zone are (1) all census tracts that presently are part of the D.C. enterprise community designated under section 1391 (i.e., portions of Anacostia, Mt. Pleasant, Chinatown, and the easternmost part of the District) and (2) all additional census tracts within the District of Columbia where the poverty rate is at least 35 percent. The D.C. Enterprise Zone designation generally will remain in effect for five years for the period from January 1, 1998, through December 31, 2002.[45]

The following tax incentives will take effect only if, prior to January 1, 1998, a Federal law is enacted creating a District of Columbia economic development corporation that is an instrumentality of the District of Columbia government.[46]

Business development incentives.—

Empowerment zone wage credit, expensing, and tax-exempt financing.—The following tax incentives that are available under present law in empowerment zones would be available in the D.C. Enterprise Zone (modified as described below): (1) a 20-percent wage credit for the first $15,000 of wages paid to D.C. Enterprise Zone residents who work in the D.C. Enterprise Zone; (2) an additional $20,000 of expensing under Code section 179 for qualified zone property; and (3) special tax-exempt financing for certain zone facilities.

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[45] The status of certain census tracts within the District as an enterprise community designated under section 1391 also terminates on December 31, 2002.

[46] In addition, the bill assumes the enactment of certain modifications to Federal law (other than Federal tax laws contained in the Internal Revenue Code) similar to those proposed by the Administration that would clarify and expand the District's authority to issue revenue bonds.

In general, the wage credit for certain D.C. Enterprise Zone residents who work in the D.C. Enterprise Zone is the same as is available in empowerment zones under present law. However, the wage credit rate remains at 20 percent for the D.C. Enterprise Zone for the period 1998 through 2002 (and does not phase down to 15 percent in the year 2002 as under present-law section 1396). The wage credit is effective for wages paid (or incurred) to a qualified individual after December 31, 1997, and before January 1, 2003.

The increased expensing under Code section 179 is effective for property placed in service in taxable years beginning after December 31, 1997, and before January 1, 2003. Thus, qualified D.C. Zone property placed in service in taxable years beginning in 1998 is eligible for up to $38,500 of expensing.

A qualified D.C. Zone business (defined as under present law section 1394(b)(3)) is permitted to borrow proceeds from the issuance of qualified enterprise zone facility bonds. Such bonds can be issued only by a newly created economic development corporation and are subject to the requirements applicable under present law to enterprise zone facility bonds, except that the amount of outstanding bond proceeds that can be borrowed by any qualified District business cannot exceed $15 million (rather than $3 million). The special tax-exempt bond provisions apply to bonds issued after December 31, 1997, and prior to January 1, 2003.

* * *

Zero percent capital gains rate.—The bill provides a zero percent capital gains rate for capital gains from the sale of certain qualified D.C Zone assets held for more than five years. In general, D.C. Zone assets mean stock or partnership interests held in or tangible property held by a D.C. Zone business. For this purpose, a D.C. Zone business is defined as an enterprise zone business under present-law section 1397B.

"D.C. Zone business stock" is stock in a domestic corporation originally issued after December 31, 1997, that, at the time of issuance [48] and during substantially all of the taxpayer's holding period, was a D.C. Zone business, provided that such stock was acquired by the taxpayer on original issue from the corporation solely in exchange for cash.[49] A "D.C. Zone partnership interest" is a domestic partnership interest originally issued after December 31, 1997, that is acquired by the taxpayer from the partnership solely in exchange for cash before January 1, 2003, provided that, at the time such interest was acquired [50] and during substantially all of the taxpayer's holding period, the partnership was a D.C. Zone business. Finally, "D.C. Zone business property" is tangible property acquired by the taxpayer by purchase (within the meaning of present law section 179(d)(2)) after December 31, 1997, and before January 1, 2003, provided that the original use of such property in the D.C. Enterprise Zone commences with the taxpayer and substantially all of the use of such property during substantially all of the taxpayer's holding period was in a D.C. Zone business of the taxpayer.

A special rule provides that, in the case of business property that is "substantially renovated," such property need not be acquired by the taxpayer after December 31, 1997, nor need the original use of such property in the D.C. Enterprise Zone commence with the taxpayer. For these purposes, property is treated as "substantially renovated" if, prior to January 1, 2003, additions to basis with respect to such property in the hands of the taxpayer during any 24-month period beginning after December 31, 1997, exceed the greater of (1) an amount equal to the adjusted basis at the beginning of such 24-month period in the hands of the taxpayer, or (2) $5,000. Thus, substantially renovated real estate located in the D.C. Enterprise Zone may constitute D.C. Zone business property. However, the bill specifically excludes land that is not an integral part of a D.C. Zone business from the definition of D.C. Zone business property.

In addition, qualified D.C. Zone assets include property that was a qualified D.C. Zone asset in the hands of a prior owner, provided that at the time of acquisition, and during substantially all of the subsequent purchaser's holding period, either (1) substantially all of the use of the property is in a D.C. Zone business, or (2) the property is an ownership interest in a D.C. Zone business. [51]

In general, gain eligible for the zero percent tax rate means gain from the sale or exchange of a qualified D.C. Zone asset that is (1) a capital asset or (2) property used in the trade or business as defined in section 1231(b). Gain attributable to periods before December 31, 1997, and after December 31, 2007, is not qualified capital gain. No gain attributable to real prop-

[48] In the case of a new corporation, it is sufficient if the corporation is being organized for purposes of being a D.C. Zone business.

[49] Qualified D.C. Zone business stock does not include any stock acquired from a corporation which made a substantial stock redemption or distribution (without a bona fide business purpose therefore) in an attempt to avoid the purposes of the provision. A similar rule applies with respect to qualified D.C Zone partnership interests.

[50] In the case of a new partnership, it is sufficient if the partnership is being formed for purposes of being a D.C. Zone business.

[51] The termination of the D.C. Zone designation will not, by itself, result in property failing to be treated as a qualified D.C. Zone asset. However, capital gain eligible for the zero percent capital gains rate does not include any gain attributable to periods after December 31, 2007.

erty, or an intangible asset, which is not an integral part of a D.C. Zone business qualifies for the zero percent rate.

The bill provides that property that ceases to be a qualified D.C. Zone asset because the property is no longer used in (or no longer represents an ownership interest in) a D.C. Zone business after the five-year period beginning on the date the taxpayer acquired such property would continue to be treated as a D.C. Zone asset. Under this rule, the amount of gain eligible for the zero percent capital gains rate cannot exceed the amount which would be qualified capital gain had the property been sold on the date of such cessation.

Special rules are provided for pass-through entities (i.e., partnerships, S corporations, regulated investment companies, and common trust funds). In the case of a sale or exchange of an interest in a pass-through entity that was not a D.C. Zone business during substantially all of the period that the taxpayer held the interest, the zero percent capital gains rate applies to the extent that the gain is attributable to amounts that would have been qualified capital gain had the assets been sold for their fair market value on the date of the sale or exchange of the interest in the pass-through entity. This rule applies only if the interest in the pass-through entity were held by the taxpayer for more than five years. In addition, the rule applies only to qualified D.C. Zone assets that were held by the pass-through entity for more than five years, and throughout the period that the taxpayer held the interest in the pass-through entity.

The bill also provides that in the case of a transfer of a qualified D.C. Zone asset by gift, at death, or from a partnership to a partner that held an interest in the partnership at the time that the qualified D.C. Zone asset was acquired, (1) the transferee is to be treated as having acquired the asset in the same manner as the transferor, and (2) the transferee's holding period includes that of the transferor. In addition, rules similar to those contained in section 1202(i)(2) regarding treatment of contributions to capital after the original issuance date and section 1202(j) regarding treatment of certain short positions apply.

* * *

Effective date.—The D.C. tax incentives generally are effective January 1, 1998, and remain in effect for five years until the termination of the D.C. Enterprise Zone designation on December 31, 2002. However, the zero percent tax rate for capital gains * * * effective for the period 1998-2007.

Senate Committee Report

* * *

First-time homebuyer credit.—The bill provides first-time homebuyers of a principal residence in the District a tax credit of up to $5,000 of the amount of the purchase price. The $5,000 maximum credit amount applies both to individuals and married couples. Married individuals filing separately can claim a maximum credit of $2,500 each. The Secretary of Treasury is directed to prescribe regulations allocating the credit among unmarried purchasers of a residence.[44]

To qualify as a "first-time homebuyer," neither the individual (nor the individual's spouse, if married) can have had a present ownership interest in a principal residence in the District for the one-year period prior to the date of acquisition of the principal residence.[45]

A taxpayer will be treated as a first-time homebuyer with respect to only one residence—i.e., the credit may be claimed one time only. The date of acquisition is the date on which a binding contract to purchase the principal residence is entered into or the date on which construction or reconstruction of such residence commences.

The credit applies to purchases after the date of enactment and before January 1, 2002. Any excess credit may be carried forward indefinitely to succeeding taxable years.

* * *

Effective dates.—The D.C. first-time homebuyer credit is effective for purchases after the date of enactment and before January 1, 2002. * * *

Conference Committee Report

The conference agreement follows the House bill in part and the Senate amendment in part.

Designation of D.C Enterprise Zone.—The conference agreement includes the House bill provision that designates certain economically depressed census tracts within the District of Columbia as the "D.C. Enterprise Zone," within which businesses and individual residents are eli-

[44] The provision of the bill that excludes sales of certain personal residences from the real estate transaction reporting requirement would not apply to sales of personal residences in the District of Columbia. In addition, the Committee anticipates that the Secretary of Treasury will require such information as may be necessary to verify eligibility for the D.C. first-time homebuyer credit.

[45] Special rules apply to members of the Armed Forces and certain individuals with tax homes outside the United States with respect to whom the rollover period available under section 1034 (as in effect prior to the enactment of the bill) is suspended pursuant to sections 1034(h) or (k).

gible for special tax incentives. Under the conference agreement, however, the census tracts that compose the D.C. Enterprise Zone for purposes of the wage credit, expensing, and tax-exempt financing incentives are expanded to include census tracts within the District of Columbia where the poverty rate is not less than 20 percent. Thus, the D.C. Enterprise Zone consists of (1) all census tracts that presently are part of the D.C. enterprise community designated under Code section 1391 (i.e., portions of Anacostia, Mt. Pleasant, Chinatown, and the easternmost part of the District) and (2) all additional census tracts within the District of Columbia where the poverty rate is not less than 20 percent. As under the House bill, the D.C. Enterprise Zone designation generally will remain in effect for five years for the period from January 1, 1998, through December 31, 2002.

Empowerment zone wage credit, expensing, and tax-exempt financing.—The conference agreement includes the House bill provision with respect to the tax incentives that are available in the D.C. Enterprise Zone, modified to provide that the wage credit is available with respect to all residents of the District and is not limited to residents of the D.C. Enterprise Zone and to eliminate the requirement that 35 percent of the employees of a qualified "D.C. Zone business" must be residents of the D.C. Enterprise Zone.[26] Thus, the following tax incentives that are available under present law in empowerment zones generally will be available in the D.C. Enterprise Zone: (1) a 20-percent wage credit for the first $15,000 of wages paid to D.C. residents who work in the D.C. Enterprise Zone; (2) an additional $20,000 of expensing under Code section 179 for qualified zone property; and (3) special tax-exempt financing for certain zone facilities.[27] The conference agreement does not include the provision limiting the special tax-exempt financing benefits to bonds issued by the Economic Development Corporation.

Zero-percent capital gains rate.—The conference agreement includes the House bill provision that provides a zero-percent capital gains rate for capital gains from the sale of certain qualified D.C Zone assets held for more than five years. For purposes of the zero-percent capital gains rate, the D.C. Enterprise Zone is defined to include all census tracts within the District of Columbia where the poverty rate is not less than 10 percent.

For purposes of the zero-percent capital gains rate, the definition of qualified "D.C. Zone business" generally is the same as the definition applicable for purposes of the increased expensing described above. However, solely for purposes of the zero-percent capital gains rate, a qualified "D.C. Zone business" must derive at least 80 percent (as opposed to 50 percent) of its total gross income from the active conduct of a "qualified business" within the D.C. Enterprise Zone.

First-time homebuyer tax credit.—The conference agreement includes the Senate amendment provision that allows first-time homebuyers of a principal residence in the District a tax credit of up to $5,000 of the amount of the purchase price, except that the credit phases out for individual taxpayers with adjusted gross income between $70,000 and $90,000 ($110,000-$130,000 for joint filers). The conference agreement clarifies that the credit is available with respect to purchases of existing property as well as new construction, and specifies that a taxpayer's basis in a property is reduced by the amount of any homebuyer tax credit claimed with respect to such property. In addition, the conference agreement sunsets the credit after December 31, 2000. Thus, the credit is available with respect to property purchased after the date of enactment and before January 1, 2001.

[¶ 10,485] Act Sec. 801. Law at ¶ 5025. CCH Explanation at ¶ 320.

Welfare-to-Work Tax Credit

House Committee Report

[*Incentives for employing long-term family assistance recipients*]

Welfare-to-work tax credit.—The bill provides to employers a credit on the first $20,000 of eligible wages paid to qualified long-term family assistance (AFDC or its successor program) recipients during the first two years of employment. The credit is 35% of the first $10,000 of eligible wages in the first year of employment and 50% of the first $10,000 of eligible wages in the second

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[26] The provision of the conference agreement that authorizes the designation of additional empowerment zones also modifies the definition of an enterprise zone business to provide that, in addition to satisfying the other requirements of section 1397B, at least 50 percent (as opposed to 80 percent under present law) of the total gross income of a qualified enterprise zone business must be derived from the active conduct of a "qualified business" within a zone or community. The conference agreement makes certain other modifications to the definition of an enterprise zone business as well. This modified definition of enterprise zone business, determined without regard to the 35-percent zone resident employee requirement, generally applies for purposes of the increased expensing and tax-exempt financing available in the D.C. Enterprise Zone.

[27] The provision of the conference agreement that authorizes the designation of additional empowerment zones contains certain modifications to the rules applicable to present-law empowerment zone facility bonds. Such modifications (not including the exception to the volume cap) will apply in the D.C. Enterprise Zone as well.

year of employment. The maximum credit is $8,500 per qualified employee.

Qualified long-term family assistance recipients are: (1) members of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) members of a family that has received family assistance for a total of at least 18 months (whether or not consecutive) after the date of enactment of this credit if they are hired within 2 years after the date that the 18-month total is reached; and (3) members of a family who are no longer eligible for family assistance because of either Federal or State time limits, if they are hired within 2 years after the Federal or State time limits made the family ineligible for family assistance.

Eligible wages are amounts paid by the employer for the following: (1) educational assistance excludable under a section 127 program (or that would be excludable but for the expiration of section 127); (2) health plan coverage for the employee, but not more than the applicable premium defined under section 4980B(f)(4); and (3) dependent care assistance excludable under section 129.

Effective date.—The provision is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after January 1, 1998 and before May 1, 1999.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 10,515] Act Sec. 901. Law at ¶ 5473 and 5755. CCH Explanation at ¶ 1223.

Miscellaneous Provisions—Excise Tax

Senate Committee Report

[*General Fund highway fuels tax*]

Transfer of General Fund highway fuels tax to the Highway Trust Fund.—The bill transfers the existing General Fund excise tax of 4.3 cents per gallon on motor fuels used in highway transportation to the Highway Trust Fund, beginning on October 1, 1997, except for the temporary transfer of the 0.5 cent per gallon that will go to the Intercity Passenger Rail Fund under section 702 of the bill for the period October 1, 1997 through April 15, 2001. Of the amounts transferred to the Highway Trust fund (3.8 cents or 4.3 cents), 20 percent is to go to the Mass Transit Account and 80 percent to the Highway Account.

The increased deposits to the Highway Trust Fund may not be used to cause an increase in the allocations under section 157 of Title 23 of the U.S. Code or any other increase beyond in direct spending other than by enactment of future legislation in compliance with the Budget Enforcement Act.

Effective date.—The provision is effective on October 1, 1997.

Conference Committee Report

Transfer of revenues to Highway Trust Fund.—The conference agreement follows the Senate amendment with a modification to reflect deletion from the agreement of the Senate amendment provision transferring 0.5 cents per gallon of these revenues to a new Intercity Passenger Rail Fund. As under the Senate amendment, revenues from the 4.3-cents-per-gallon tax will be divided between the Highway Trust Fund's Highway Account (3.45 cents per gallon) and Mass Transit Account (0.85 cents per gallon).

Deposit rules for highway motor fuels taxes.—The conference agreement provides that the excise taxes imposed on gasoline (sec. 4081), diesel fuel (sec. 4081), special motor fuels (sec. 4041), and kerosene (sec. 4081) that otherwise would be required to be deposited with the Treasury after July 31, 1998, and before September 30, 1998, are not required to be deposited until October 5, 1998.

[¶ 10,520] Act Sec. 902. Law at ¶ 5473, 5483 and 5669. CCH Explanation at ¶ 1209.

Miscellaneous Provisions—Excise Tax

House Committee Report

[*Diesel fuel used in recreational motorboats*]

Repeal excise tax on diesel fuel used in recreational motorboats.—The provision repeals the application of the diesel fuel tax to fuel used in recreational motorboats.

Effective date.—The provision is effective for fuel sold after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 10,525] Act Sec. 903. Law at ¶ 5519. CCH Explanation at ¶ 1248.

Miscellaneous Provisions—Excise Tax

House Committee Report

[*Imported recycled Halon-1211*]

Continued application of tax on imported recycled Halon-1211.—The bill repeals the present-law exemption for imported recycled Halon-1211.

Effective date.—The provision is effective on the date of enactment.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 10,530] Act Sec. 904. Law at ¶ 5493 and 5495. CCH Explanation at ¶ 1255.

Miscellaneous Provisions—Excise Tax

House Committee Report

[*Uniform tax rate for vaccines*]

Uniform rate of excise tax on vaccines.—The bill replaces the present-law excise tax rates, that differ by vaccine, with a single rate tax of $0.84 per dose on any listed vaccine component. Thus, the bill provides that the tax applied to any vaccine that is a combination of vaccine components is 84 cents times the number of components in the combined vaccine. For example, the MMR vaccine is to be taxed at a rate of $2.52 per dose and the DT vaccine is to be taxed at rate of $1.68 per dose.

In addition, the provision adds three new taxable vaccines to the present-law taxable vaccines: (1) HIB (hemophilus influenza type B); (2) Hepatitis B; and (3) varicella (chickenpox). The three newly listed vaccines also are subject to the 84-cents per dose excise tax.

Effective date.—The provision is effective for vaccine purchases after September 30, 1997. No tax is to be collected or refunds permitted for amounts held for sale on October 1, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill regarding rates of tax and taxable vaccines. In addition, the committee report on the Senate amendment directs the Secretary of the Treasury to undertake a study of the efficacy of the new flat-rate vaccine tax system as a means to finance the Vaccine Injury Compensation Trust Fund. Results of the Treasury study are to be submitted to the Senate Committee on Finance and the House Committee on Ways and Means by September 30,1999.

Effective date.—The provision is effective for vaccine purchases after September 30, 1997. No floor stocks tax is to be collected or refunds permitted for amounts held for sale on October 1, 1997. Returns to the manufacturer occurring on or after October 1, 1997, are assumed to be returns of vaccines to which the new rates of tax apply.

Conference Agreement.—The conference agreement generally follows the House bill and the Senate amendment by imposing a uniform rate of tax, but at a rate of $0.75 per dose on any listed vaccine component. The conference agreement also adds the HIB (haemophilus influenza type B), Hepatitis B, and varicella (chickenpox) vaccines to the list of taxable vaccines.

The conference agreement does not require the Secretary to study the new vaccine tax structure.

Effective date.—The provision is effective for sales after the date of enactment. No floor stocks tax is to be collected, or floor stocks refunds permitted, for vaccines held on the effective date. For the purpose of determining the amount of refund of tax on a vaccine returned to the manufacturer or importer, for vaccines returned after the date of enactment and before January 1, 1999, the amount of tax assumed to have been paid on the initial purchase of the returned vaccine shall not exceed $0.75 per dose.

[¶ 10,535] Act Sec. 905. Law at ¶ 5667. CCH Explanation at ¶ 1219.

Miscellaneous Provisions—Excise Tax

House Committee Report

[*Gasoline chain retailers as wholesale distributors*]

Treat certain gasoline "chain retailers" as wholesale distributors under the gasoline excise tax refund rules.—The definition of wholesale distributor is expanded to include certain "chain retailers"—retailers who own and make retail sales from 10 or more retail gasoline outlets. This modification conforms the definition of wholesale distributor to that which existed before 1987 when the point of collection of the gasoline tax was moved from the wholesale distribution level to removal from a terminal facility.

Effective date.—The provision is effective after September 30, 1997.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 10,540] Act Sec. 906. Law at ¶ 5469 and 5471. CCH Explanation at ¶ 1247.

Miscellaneous Provisions—Excise Tax

House Committee Report

[*Exemption from luxury auto classification*]

Exemption of electric and other clean-fuel motor vehicles from luxury automobile classification.—The bill modifies the threshold above which the luxury excise tax on automobiles will apply for each of two identified classes of automobiles both in the case of a purchase of a vehicle and in the case of the separate purchase of a vehicle and parts and accessories therefor. First, for an automobile that is not a clean-burning fuel vehicle to which retrofit parts and components are installed to make the vehicle a clean-burning vehicle (as defined under sec. 179A(c)(1)(A)), the threshold would be $30,000, as adjusted for inflation under present law, plus an amount equal to the increment to the retail value of the automobile attributable to the retrofit parts and components installed. For example, assume that in 1997, after the date of enactment, an individual purchases a clean-burning fuel vehicle for $43,000. Further assume that had the individual purchased the identical vehicle, without having had certain components replaced to qualify it as clean burning, the price paid would have been $39,000. The incremental increase in the price of the vehicle due to the installation of the qualified property is $4,000, and the luxury tax would be applied for the amount paid above a threshold of $38,000 (the $34,000 base threshold applicable for 1997 plus $4,000 for the value of the incremental components). The tax would apply to $5,000 of the sales price ($43,000 less the $38,000 threshold).

In the case of a passenger vehicle designed to be propelled primarily by electricity and built by an original equipment manufacturer, the threshold applicable for any year is modified to equal 150 percent of $30,000 with the result increased for inflation occurring after 1990 and rounded to next lowest multiple of $2,000.

For all other vehicles, the threshold remains equal to that provided under present law.

Effective date.—The provision is effective for sales and installations occurring on or after the date of enactment.

Conference Committee Report

The conference agreement follows the House bill, with a modification to the effective date that provides that the provision is effective for sales and installations occurring after the date of enactment.

[¶ 10,545] Act Sec. 907. Law at ¶ 5473. CCH Explanation at ¶ 1216.

Miscellaneous Provisions—Excise Tax

Senate Committee Report

[*Alternative fuels tax*]

Tax certain alternative fuels based on energy equivalency to gasoline.—The tax rates on propane, LNG, and methanol from natural gas are adjusted to reflect the respective energy equivalence of the fuels to gasoline. The revised tax rates on these fuels are: propane, 13.6 cents per gallon;

LNG, 11.9 cents per gallon; and methanol from natural gas, 9.15 cents per gallon.

Effective date.—The provision is effective for fuels sold or used after September 30, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 10,550] Act Sec. 908. Law at ¶ 5543. CCH Explanation at ¶ 1276.

Miscellaneous Provisions—Excise Tax

Senate Committee Report

[*Alcohol excise tax on hard cider*]

Provide a lower rate of alcohol excise tax on certain hard cider.—The bill adjusts the tax rate on apple cider having an alcohol content of no more than seven percent to 22.6 cents per gallon for those persons who produce more than 100,000 gallons of apple cider during a calendar year. The tax rate applicable to apple cider produced by persons who produce 100,000 gallons or less in a calendar year will remain as under present law and those persons may continue to claim the credit permitted for small wineries. Apple cider production will continue to be counted in determining whether other production of a producer qualifies for the tax credit for small producers. The bill does not change the classification of qualifying apple cider as wine.

Effective date.—The provision is effective for hard cider removed after September 30, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 10,555] Act Sec. 909. Law at ¶ 7007. CCH Explanation at ¶ 1277.

Miscellaneous Provisions—Excise Tax

Senate Committee Report (Related Non-Code Provision)

[*Collection point of distilled spirits excise tax*]

Study feasibility of moving collection point for distilled spirits excise tax.—The Treasury Department is directed to study options for changing the point at which the distilled spirits excise tax is collected. One of the options evaluated should be collecting the tax at the point at which the distilled spirits are removed from registered wholesale warehouses. As part of this study, the Treasury is to focus on administrative issues associated with the identified options, including the effects on tax compliance. For example, the Treasury is to evaluate the actual compliance record of wholesale dealers that currently paid the excise tax on imported bottled distilled spirits, and the compliance effects of allowing additional wholesale dealers to be distilled spirits taxpayers. The study also is to address the number of taxpayers involved, the types of financial responsibility requirements that might be needed, any special requirements regarding segregation of non-tax-paid distilled spirits from other products carried by the potential new taxpayers. The study further is to review the effects of the options on Treasury staffing and other budgetary resources as well as projections of the time between when tax currently is collected and the time when tax otherwise would be collected.

[*Effective date.*—] The study is required to be completed and transmitted to the Committee on Finance and the Committee on Ways and Means no later than January 31, 1998.

Conference Committee Report

The conference agreement follows the Senate amendment with a modification delaying the due date of the study to March 31, 1998.

[¶ 10,560] Act Sec. 910. Law at ¶ 5567. CCH Explanation at ¶ 1283.

Miscellaneous Provisions—Excise Tax

Senate Committee Report

[*Wine labels*]

Codify Treasury Department regulations regulating wine labels.—The current Treasury Department regulations governing the use of semi-generic wine designations which reflect geographic origin are codified into the Code's wine labeling provisions.

Effective date.—The provision is effective on the date of enactment.

Conference Committee Report

The conference agreement follows the Senate amendment with a modification deleting the Secretary of the Treasury's discretion to eliminate currently listed semi-generic names.

[¶ 10,585] Act Sec. 911. Law at ¶ 5739. CCH Explanation at ¶ 1067.

Miscellaneous Provisions—Disaster Relief

House Committee Report

[*Presidentially declared disaster: Deadline extension*]

Authority to postpone certain tax-related deadlines by reason of presidentially declared disaster.—The bill provides that, in the case of a taxpayer determined to be affected by a Presidentially declared disaster, the Secretary may specify that, for a period of up to 90 days, certain taxpayer deadlines are postponed. The deadlines that may be postponed are the same as are postponed by reason of service in a combat zone. The provision does not apply for purposes of determining interest on any overpayment or underpayment.

Effective date.—The provision is effective for any period for performing an act that has not expired before the date of enactment.

Conference Committee Report

The conference agreement follows the House bill, except that it is applicable to all deadlines (not just taxpayer deadlines).

[¶ 10,590] Act Sec. 912. Law at ¶ 5071. CCH Explanation at ¶ 103.

Miscellaneous Provisions—Disaster Relief

House Committee Report

[*Appraisals to establish disaster loss*]

Use of certain appraisals to establish amount of disaster loss.—The bill provides that nothing in the Code should be construed to prohibit Treasury from issuing guidance providing that an appraisal for the purpose of obtaining a Federal loan or Federal loan guarantee as the result of a Presidentially declared disaster may be used to establish the amount of a disaster loss.

Effective date.—The provision is effective on the date of enactment.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 10,595] Act Sec. 913. Law at ¶ 5159 and 5321. CCH Explanation at ¶ 367.

Miscellaneous Provisions—Disaster Relief

House Committee Report

[*Sale of livestock: Weather-related conditions*]

Treatment of livestock sold on account of weather-related conditions.—The bill amends Code section 451(e) to provide that a cash-method taxpayer whose principal trade or business is farming and who is forced to sell livestock due not only to drought (as under present law), but also to floods or other weather-related conditions, may elect to include income from the sale of the livestock in the taxable year following the taxable year of the sale. This elective deferral of income is available only if the taxpayer establishes that,

under the taxpayer's usual business practices, the sale would not have occurred but for the drought, flood or other weather-related conditions that resulted in the area being designated as eligible for Federal assistance.

In addition, the bill amends Code section 1033(e) to provide that the sale of livestock (other than poultry) that are held for draft, breeding, or dairy purposes in excess of the number of livestock that would have been sold but for drought (as under present law), flood or other weather-related conditions is treated as an involuntary conversion.

Effective date.—The provision applies to sales and exchanges after December 31, 1996.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 10,615] Act Sec. 914. Law at ¶ 5061. CCH Explanation at ¶ 349.

Miscellaneous Provisions—Disaster Relief

House Committee Report

[*Mortgage bond financing for residences in disaster areas*]

Mortgage bond financing for residences located in Presidentially declared disaster areas.—The bill waives the first time homebuyer requirement, the income limits, and the purchase price limits for loans to finance homes in certain Presidentially declared disaster areas. The waiver applies only during the one-year period following the date of the disaster declaration.

Effective date.—The provision applies to loans financed with bonds issued after December 31, 1996, and before January 1, 2000.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill except for the effective date.

Effective date.—The provision applies to loans financed with bonds issued after December 31, 1996, and before January 1, 1999.

Conference Agreement.—The conference agreement allows the waivers of the first-time homebuyer requirement, the income limits, and the purchase price limits for loans to finance homes in certain Presidentially declared disaster areas. The waiver applies only during the two-year period following the date of disaster declaration.

Effective date.—The provision applies to loans financed with bonds issued after December 31, 1996, and before January 1, 1999 (i.e., is the same as the Senate amendment).

[¶ 10,620] Act Sec. 915. Law at ¶ 7010. CCH Explanation at ¶ 1009.

Miscellaneous Provisions—Disaster Relief

Conference Committee Report (Related Non-Code Provision)

[*Presidentially declared disaster: Interest abated*]

Requirement to abate interest by reason of Presidentially declared disaster.—

Senate [Floor] Amendment.—The Senate amendment requires the IRS to abate interest for the same period of time for which the IRS has provided an extension of time to file tax returns and pay taxes for individuals located in Presidentially declared disaster areas during 1997.

Effective date.—Disasters occurring in 1997.

Conference Agreement.—The conference agreement follows the Senate amendment.

[¶ 10,635] Act Sec. 921. Law at ¶ 7012. CCH Explanation at ¶ 1114.

Miscellaneous Provisions—Employment Taxes

House Committee Report (Related Non-Code Provision)

[*Retail securities brokers*]

Clarification of standard to be used in determining tax status of retail securities brokers.—Under the bill, in determining the status of a registered representative of a broker-dealer for Federal tax purposes, no weight may be given to instructions from the service recipient which are imposed only in compliance with governmental investor protection standards or investor protection standards imposed by a governing body pursuant to a delegation by a Federal or State agency.

Effective date.—The provision is effective with respect to services performed after December 31, 1997. No inference is intended that the treatment under the proposal is not present law.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 10,640] Act Sec. 922. Law at ¶ 5403 and 7013. CCH Explanation at ¶ 1117.

Miscellaneous Provisions—Employment Taxes

House Committee Report (Code and Related Non-Code Provisions)

[*Former insurance salesmen termination payments*]

Clarification of exemption from self-employment tax for certain termination payments received by former insurance salesmen.—The bill codifies case law by providing that net earnings from self employment do not include any amount received during the taxable year from an insurance company on account of services performed by such individual as an insurance salesman for such company if (1) such amount is received after termination of the individual's agreement to perform services for the company, (2) the individual performs no services for the company after such termination and before the close of the taxable year, (3) the amount of the payment depends solely on policies sold by the individual during the last year of the agreement and the extent to which such policies remain in force for some period after such termination, and does not depend on the length of service or overall earnings from services performed for the company, and (4) the payments are conditioned upon the salesman agreeing not to compete with the company for at least one year following such termination.

The bill will also amend the Social Security Act to provide that such termination payments are not treated as earnings for purposes of determining social security benefits.

No inference is intended with respect to the SECA tax treatment of payments that are not described in the proposal.

Effective date.—The provision is effective with respect to payments after December 31, 1997. No inference is intended that the proposal is not present law.

Conference Committee Report

The conference agreement follows the House bill, with clarifications with respect to the requirement as to the amount of the payments. The conference agreement clarifies that the provision applies if the amount of the payment depends primarily on policies sold by or credited to the account of the individual during the last year of the service agreement and/or the extent to which such policies remain in force for some period after such termination and does not depend on length of service or overall earnings. The conference agreement clarifies that the eligibility for the payment can be based on length of service or overall earnings.

[¶ 10,655] Act Sec. 931. Law at ¶ 7014. CCH Explanation at ¶ 1040.

Miscellaneous Provisions—Small Business

Senate Committee Report (Related Non-Code Provision)

[*Electronic Federal Tax Payment System*]

Delay imposition of penalties for failure to make payments electronically through EFTPS until after June 30, 1998.—The bill provides that no penalty shall be imposed solely by reason of a failure to use EFTPS prior to July 1, 1998, if the taxpayer was first required to use the EFTPS system on or after July 1, 1997.

Effective date.—The provision is effective on the date of enactment.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 10,660] Act Sec. 932. Law at ¶ 5107. CCH Explanation at ¶ 109.

Miscellaneous Provisions—Small Business

House Committee Report

[*Home office deduction: Place of business*]

Home office deduction: clarification of definition of principal place of business.—Section 280A is amended to specifically provide that a home office qualifies as the "principal place of business" if (1) the office is used by the taxpayer to conduct administrative or management activities of a trade or business and (2) there is no other fixed location of the trade or business where the taxpayer conducts substantial administrative or management activities of the trade or business. As under present law, deductions will be allowed for a home office meeting the above two-part test only if the office is exclusively used on a regular basis as a place of business by the taxpayer and, in the case of an employee, only if such exclusive use is for the convenience of the employer.

Thus, under the bill, a home office deduction is allowed (subject to the present-law "convenience of the employer" rule governing employees) if a portion of a taxpayer's home is exclusively and regularly used to conduct administrative or management activities for a trade or business of the taxpayer, who does not conduct substantial administrative or management activities at any other fixed location of the trade or business, regardless of whether administrative or management activities connected with his trade or business (e.g., billing activities) are performed by others at other locations. The fact that a taxpayer also carries out administrative or management activities at sites that are not fixed locations of the business, such as a car or hotel room, will not affect the taxpayer's ability to claim a home office deduction under the bill. Moreover, if a taxpayer conducts some administrative or management activities at a fixed location of the business outside the home, the taxpayer still will be eligible to claim a deduction so long as the administrative or management activities conducted at any fixed location of the business outside the home are not substantial (e.g., the taxpayer occasionally does minimal paperwork at another fixed location of the business). In addition, a taxpayer's eligibility to claim a home office deduction under the bill will not be affected by the fact that the taxpayer conducts substantial *non-administrative* or *non-management* business activities at a fixed location of the business outside the home (e.g., meeting with, or providing services to, customers, clients, or patients at a fixed location of the business away from home).

If a taxpayer *in fact* does not perform substantial administrative or management activities at any fixed location of the business away from home, then the second part of the test will be satisfied, regardless of whether or not the taxpayer opted not to use an office away from home that was available for the conduct of such activities. However, in the case of an employee, the question whether an employee chose not to use suitable space made available by the employer for administrative activities is relevant to determining whether the present-law "convenience of the employer" test is satisfied. In cases where a taxpayer's use of a home office does not satisfy the provision's two-part test, the taxpayer nonetheless may be able to claim a home office deduction under the present-law "principal place of business" exception or any other provision of section 280A.

Effective date.—The provision applies to taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the House bill, except that the provision is effective for taxable years beginning after December 31, 1998.

[¶ 10,665] Act Sec. 933. Law at ¶ 5373. CCH Explanation at ¶ 361.

Miscellaneous Provisions—Small Business

Conference Committee Report

[*Averaging of farm income*]

Senate [Floor] Amendment.—An individual taxpayer is allowed to elect to compute his or her current year tax liability by averaging, over the prior three-year period, all or a portion of his or her taxable income from the trade of business of farming.

Effective date.—The provision is effective for taxable years beginning after the date of enactment and before January 1, 2001.

Conference Agreement.—The conference agreement includes the Senate amendment with modifications. The conference agreement clarifies that the provision operates such that an electing eligible taxpayer (1) designates all or a portion of his

or her taxable income from the trade or business of farming from the current year as "elected farm income;" (2) allocates one-third of such "elected farm income" to each of the prior three taxable years; and (3) determines his or her current year section 1 tax liability by determining the sum of (a) his or her current year section 1 liability without the elected farm income allocated to the three prior taxable years plus (b) the increases in the section 1 tax for each of the three prior taxable years by taking into account the allocable share of the elected farm income for such years. If a taxpayer elects the operation the provision for a taxable year, the allocation of elected farm income among taxable years pursuant to the election shall apply for purposes of any election in a subsequent taxable year.

The provision does not apply for employment tax purposes, or to an estate or a trust. Further, the provision does not apply for purposes of the alternative minimum tax under section 55. Finally, the provision does not require the recalculation of the tax liability of any other taxpayer, including a minor child required to use the tax rates of his or her parents under section 1(g).

The election shall be made in the manner prescribed by the Secretary of the Treasury and, except as provided by the Secretary, shall be irrevocable. In addition, the Secretary of the Treasury shall prescribe such regulations as are necessary to carry out the purposes of the provision, including regulations regarding the order and manner in which items of income, gain, deduction, loss, and credits (and any limitations thereon) are to be taken into account for purposes of the provision and the application of the provision to any short taxable year. It is expected that such regulations will deny the multiple application of items that carryover from one taxable year to the next (e.g., net operating loss or tax credit carryovers).

The provision applies to taxable years beginning after December 31, 1997, and before January 1, 2001.

[¶ 10,670] Act Sec. 934. Law at ¶ 5067. CCH Explanation at ¶ 863.

Miscellaneous Provisions—Small Business

Conference Committee Report

[*Health insurance for self-employed*]

Health insurance for self-employed.—

Senate [Floor] Amendment.—The Senate amendment permits self-employed individuals to deduct a higher percentage of the amount paid for health insurance as follows: the deduction is 50 percent in 1997 and 1998; 60 percent in 1999 through 2002; 70 percent in 2003; 80 percent in 2004; 85 percent in 2005; 90 percent in 2006; and 100 percent in 2007 and all years thereafter.

Effective date.—The provision is effective for taxable years beginning after December 31, 1996.

Conference Agreement.—The conference agreement follows the Senate amendment, with modifications. Under the conference agreement, the self-employed health deduction is phased up as follows: the deduction is 40 percent in 1997, 45 percent in 1998 and 1999, 50 percent in 2000 and 2001, 60 percent in 2002, 80 percent in 2003 through 2005, 90 percent in 2006, and 100 percent in 2007 and thereafter.

[¶ 10,675] Act Sec. 935. Law at ¶ 7015. CCH Explanation at ¶ 463.

Sense of the Senate Resolutions

Conference Committee Report (Related Non-Code Provision)

[*Self-employment taxes of limited partners*]

Sense of the Senate regarding self-employment taxes of limited partners.—

Senate [Floor] Amendment.—It is the Sense of the Senate that the Department of the Treasury should withdraw the proposed regulations defining limited partner, and that the Congress should determine the tax law governing self-employment income.

Conference Agreement.—The conference agreement provides that any regulations relating to the definition of a limited partner for self-employment tax purposes shall not be issued or effective before July 1, 1998.

[¶ 10,715] Act Sec. 941. Law at ¶ 5081. CCH Explanation at ¶ 330.

Other Miscellaneous Provisions

Senate Committee Report

[*Environmental remediation costs*]

Expensing of environmental remediation costs ("brownfields").—The bill provides that taxpayers could elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred. The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site. In general, any expenditure for the acquisition of depreciable property used in connection with the abatement or control of hazardous substances at a qualified contaminated site does not constitute a qualified environmental remediation expenditure. However, depreciation deductions allowable for such property which would otherwise be allocated to the site under the principles set forth in *Comm'r v. Idaho Power Co.*[65] and section 263A are treated as qualified environmental remediation expenditures.

A "qualified contaminated site" generally is any property that (1) is held for use in a trade or business, for the production of income, or as inventory; (2) is certified by the appropriate State environmental agency to be located within a targeted area; and (3) contains (or potentially contains) a hazardous substance (so-called "brownfields"). Targeted areas would mean (1) empowerment zones and enterprise communities (as designated under present law and the D.C. Enterprise Zone designated under the bill); and (2) sites announced before February, 1997, as being subject to one of the 76 Environmental Protection Agency (EPA) Brownfields Pilots.

Both urban and rural sites qualify. However, sites that are identified on the national priorities list under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) cannot be targeted areas. Appropriate State environmental agencies are designated by the EPA; if no State agency is designated, the EPA is responsible for providing the certification. Hazardous substances generally are defined by reference to sections 101(14) and 102 of CERCLA, subject to additional limitations applicable to asbestos and similar substances within buildings, certain naturally occurring substances such as radon, and certain other substances released into drinking water supplies due to deterioration through ordinary use.

The bill further provides that, in the case of property to which a qualified environmental remediation expenditure otherwise would have be capitalized, any deduction allowed under the bill would be treated as a depreciation deduction and the property would be treated as subject to section 1245. Thus, deductions for qualified environmental remediation expenditures would be subject to recapture as ordinary income upon sale or other disposition of the property.

Effective date.—The provision applies to eligible expenditures incurred after the date of enactment.

Conference Committee Report

The conference agreement follows the Senate amendment, except that the definition of "targeted areas" is expanded to include population census tracts with a poverty rate of 20 percent or more and certain industrial and commercial areas that are adjacent to such census tracts. Thus, targeted areas generally would include: (1) empowerment zones and enterprise communities as designated under present law and under the conference agreement[51] (including any supplemental empowerment zone designated on December 21, 1994); (2) sites announced before February 1997, as being subject to one of the 76 Environmental Protection Agency (EPA) Brownfields Pilots; (3) any population census tract with a poverty rate of 20 percent or more; and (4) certain industrial and commercial areas that are adjacent to tracts described in (3) above.

With respect to certification of targeted areas, the conference agreement provides that the chief executive officer of a State may, in consultation with the Administrator of the EPA, designate an appropriate State environmental agency. If no State environmental agency is so designated within 60 days of the date of enactment, the appropriate environmental agency for such State shall be designated by the Administrator of the EPA.

In addition, the conference agreement sunsets the provision after three years. Thus, the provision applies only to eligible expenditures incurred in taxable years ending after date of enactment and before January 1, 2001.

Finally, the conferees wish to clarify that providing current deductions for certain environmental remediation expenditures under the conference agreement creates no inference as to the proper treatment of other remediation expenditures not described in the agreement.

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[65] *Comm'r v. Idaho Power Co.*, 418 U.S. 1 (1974) (holding that equipment depreciation allocable to the taxpayer's construction of capital facilities must be capitalized under section 263(a)(1)).

[51] Thus, the 20 additional empowerment zones authorized to be designated under the conference agreement as well as the D.C. Enterprise Zone established under the conference agreement are targeted areas for purposes of this provision.

[¶ 10,735] Act Sec. 951, 952, 953, 954, 955 and 956. Law at ¶ 5379, 5381, 5383, 5385, 5387 and 5389. CCH Explanation at ¶ 371, 372, 373, 374, 375, 377, 378 and 379.

Other Miscellaneous Provisions

Senate Committee Report

[*Empowerment zone and enterprise communities*]

Modification of empowerment zone and enterprise community criteria in the event of future designations of additional zones and communities.—The bill modifies the present-law empowerment zone and enterprise community designation criteria under section 1392 so that, in the event that additional empowerment zones or enterprise communities are authorized to be designated in the future, any zones or communities designated in the States of Alaska or Hawaii will not be subject to the general size limitations under section 1392(a)(3), nor will such zones or communities be subject to the general poverty-rate criteria under section 1392(a)(4). Instead, nominated areas in either State will be eligible for designation as an empowerment zone or enterprise community if, for each census tract or block group within such area, at least 20 percent of the families have incomes which are 50 percent or less of the Statewide median family income. Such zones and communities will be subject to the population limitations under present-law section 1392(a)(1).

Effective date.—The provision is effective on the date of enactment.

Conference Committee Report

The conference agreement follows the Senate amendment. In addition, the conference agreement provides for the designation of 20 additional empowerment zones pursuant to slightly expanded eligibility criteria, and includes certain modifications to the definition of an enterprise zone business and the tax-exempt financing rules.

Two additional empowerment zones with same tax incentives as previously designated empowerment zones.—Under the conference agreement, the Secretary of HUD is authorized to designate two additional empowerment zones located in urban areas (thereby increasing to eight the total number of empowerment zones located in urban areas) with respect to which generally apply the same tax incentives (i.e., the wage credit, additional expensing, and special tax-exempt financing) as are available within the empowerment zones authorized by the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993). The wage credit available in the two new urban empowerment zones is modified slightly to provide that the percentage of wages taken into account for purposes of determining the wage credit is 20 percent for 2000-2004, 15 percent for 2005, 10 percent for 2006, and 5 percent for 2007. No wage credit is available in the two new urban empowerment zones after 2007.

The two additional empowerment zones are subject to the same eligibility criteria under present-law section 1392 that applies to the original six urban empowerment zones. In order to permit designation of these two additional empowerment zones, the conference agreement increases the present-law 750,000 aggregate population cap applicable to empowerment zones located in urban areas to a cap of one million aggregate population for the eight urban empowerment zones.

The two empowerment zones must be designated within 180 days after the date of enactment. However, the designations will not take effect before January 1, 2000, and generally will remain in effect for 10 years.

Designation of additional empowerment zones.—The conference agreement authorizes the Secretaries of HUD and Agriculture to designate an additional 20 empowerment zones (no more than 15 in urban areas and no more than five in rural areas).[55] With respect to these additional empowerment zones, the present-law eligibility criteria are expanded slightly. First, the square mileage limitations of present law (i.e., 20 square miles for urban areas and 1,000 for rural areas) are expanded to allow the empowerment zones to include an additional 2,000 acres. This additional acreage, which could be developed for commercial or industrial purposes, is not subject to the poverty rate criteria and could be divided among up to three noncontiguous parcels. In addition, the present-law requirement that at least half of the nominated area consist of census tracts with poverty rates of 35 percent or more does not apply. Thus, under present-law section 1392(a)(4), at least 90 percent of the census tracts within a nominated area must have a poverty rate of 25 percent or more, and the remaining census tracts must have a poverty rate of 20 percent or more.[56] For this purpose, census tracts with populations under 2,000 are treated as satisfying the 25-percent poverty rate criteria if (1) at least 75 percent

[55] Under the conference agreement, areas located within Indian reservations are eligible for designation as empowerment zones.

[56] In lieu of the poverty criteria, outmigration may be taken into account in designating one rural empowerment zone.

of the tract is zoned for commercial or industrial use and (2) the tract is contiguous to one or more other tracts that actually have a poverty rate of 25 percent or more.

Within the 20 additional empowerment zones, qualified "enterprise zone businesses" are eligible to receive up to $20,000 of additional section 179 expensing[57] and to utilize special tax-exempt financing benefits. The "brownfields" tax incentive provided under the conference agreement also is available within all designated empowerment zones. Businesses within the 20 additional empowerment zones are *not*, however, eligible to receive the present-law wage credit available within the 11 other designated empowerment zones (i.e., the wage credit would be available only in the nine present-law zones and two new urban empowerment zones designated under the conference agreement).

The 20 additional empowerment zones are required to be designated before 1999, and the designations generally will remain in effect for 10 years.

Modification of definition of enterprise zone business.—The conference agreement modifies the present-law requirement of section 1397B that an entity may qualify as an "enterprise zone business" only if (in addition to the other present-law criteria) at least 80 percent of the total gross income of such entity is derived from the active conduct of a qualified business within an empowerment zone or enterprise community. The conference agreement liberalizes this present-law requirement by reducing the percentage threshold so that an entity could qualify as an enterprise zone business if at least 50 percent of the total gross income of such entity is derived from the active conduct of a qualified business within an empowerment zone or enterprise community (assuming that the other criteria of section 1397B are satisfied).

In addition, section 1397B is modified so that rather than requiring that "substantially all" tangible and intangible property (and employee services) of an enterprise zone business be used (and performed) within a designated zone or community, a "substantial portion" of tangible and intangible property (and employee services) of an enterprise zone business would be required to be used (and performed)) within a designated zone or community. Moreover, the conference agreement further amends the section 1397B rule governing intangible assets so that a substantial portion of an entity's intangible property must be used in the active conduct of a qualified business within a zone or community, but there is no need (as under present law) to determine whether the use of such assets is "exclusively related to" such business. However, the present-law rule of section 1397B(d)(4) continues to apply, such that a "qualified business" would not include any trade or business consisting predominantly of the development or holding or intangibles for sale or license. The conference agreement also clarifies that an enterprise zone business that leases to others commercial property within a zone or community may rely on a lessee's certification that the lessee is an enterprise zone business. Finally, the conference agreement provides that the rental to others of tangible personal property shall be treated as a qualified business if and only if at least 50 percent of the rental of such property is by enterprise zone businesses or by residents of a zone or community (rather than the present-law requirement that "substantially all" tangible personal property rentals of an enterprise zone business satisfy this test).

This modified "enterprise zone business" definition applies to all previously designated empowerment zones and enterprise communities, the two urban empowerment zones designated under the conference agreement, as well as to the 20 additional empowerment zones authorized to be designated pursuant to the conference agreement.[58]

Tax-exempt financing rules.—

Exceptions to volume cap.—The conference agreement allows "new empowerment zone facility bonds" to be issued for qualified enterprise zone businesses in the 20 additional empowerment zones. These bonds are not subject to the State private activity bond volume caps or the special limits on issue size applicable to qualified enterprise zone facility bonds under present law. The maximum amount of these bonds that can be issued is limited to $60 million per rural zone, $130 million per urban zone with a population of less than 100,000, and $230 million per urban zone with a population of 100,000 or more.

Changes to certain rules applicable to both empowerment zone facility bonds and qualified enterprise community facility bonds.—Qualified enterprise zone businesses located in newly designated empowerment zones, as well as those located in previously designated empowerment zones and enterprise communities, would be eligible for special tax-exempt bond financing under present-law rules, subject to the modifications described below (and the exception to the volume cap described above for newly designated empowerment zones).

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[57] However, the additional section 179 expensing is *not* available within the additional 2,000 acres allowed to be included under the conference agreement within an empowerment zone.

[58] In addition, the modifications to the enterprise zone business definition will apply for purposes of defining a "D.C. Zone business" under certain provisions of the conference agreement that provide certain tax incentives of the District of Columbia.

The conference agreement waives until the end of a "startup period" the requirement that 95 percent or more of the proceeds of bond issue be used by a qualified enterprise zone business. With respect to each property, the startup period ends at the beginning of the first taxable year beginning more than two years after the later of (1) the date of the bond issue financing such property, or (2) the date the property was placed in service (but in no event more than three years after the date of bond issuance). This waiver is only available if, at the beginning of the startup period, there is a reasonable expectation that the use by a qualified enterprise zone business would be satisfied at the end of the startup period and the business makes bona fide efforts to satisfy the enterprise zone business definition.

The conference agreement also waives the requirements of an enterprise zone business (other than the requirement that at least 35 percent of the business' employees be residents of the zone or community) for all years after a prescribed testing period equal to first three taxable years after the startup period.

Finally, the conference agreement relaxes the rehabilitation requirement for financing existing property with qualified enterprise zone facility bonds. In the case of property which is substantially renovated by the taxpayer, the property need not be acquired by the taxpayer after zone or community designation or originally used by the taxpayer within the zone if, during any 24-month period after zone or community designation, the additions to the taxpayer's basis in the property exceeded 15 percent of the taxpayer's basis at the beginning of the period, or $5,000 (whichever is greater).

Effective date.—The two additional urban empowerment zones (within which generally are available the same tax incentives as are available in the empowerment zones designated pursuant to OBRA 1993) must be designated within 180 days after enactment, but the designation will not take effect before January 1, 2000. The 20 additional empowerment zones (within which the wage credit is not available) are to be designated after enactment but prior to January 1, 1999. For purposes of the additional section 179 expensing available within empowerment zones, the modifications to the definition of "enterprise zone business" are effective for taxable years beginning on or after the date of enactment.

The changes to the tax-exempt financing rules are effective for qualified enterprise zone facility bonds and the new empowerment zone facility bonds issued after the date of enactment.

[¶ 10,835] Act Sec. 961. Law at ¶ 5167. CCH Explanation at ¶ 340.

Other Miscellaneous Provisions

House Committee Report

[*Inventory accounting shrinkage*]

Shrinkage for inventory accounting.—The bill provides that a method of keeping inventories will not be considered unsound, or to fail to clearly reflect income, solely because it includes an adjustment for the shrinkage estimated to occur through year-end, based on inventories taken other than at year-end. Such an estimate must be based on actual physical counts. Where such an estimate is used in determining ending inventory balances, the taxpayer is required to take a physical count of inventories at each location on a regular and consistent basis. A taxpayer is required to adjust its ending inventory to take into account all physical counts performed through the end of its taxable year.

Effective date.—The provision is effective for taxable years ending after the date of enactment.

A taxpayer is permitted to change its method of accounting by this section if the taxpayer is currently using a method that does not utilize estimates of inventory shrinkage and wishes to change to a method for inventories that includes shrinkage estimates based on physical inventories taken other than at year-end. Such a change is treated as a voluntary change in method of accounting, initiated by the taxpayer with the consent of the Secretary of the Treasury, provided the taxpayer changes to a permissible method of accounting. The period for taking into account any adjustment required under section 481 as a result of such a change in method is 4 years.

No inference is intended by the Committee by the adoption of this provision with regard to the validity of any method of accounting for inventories under present law.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with the following clarifications regarding safe harbor methods for the estimation of inventory shrinkage.

In general.—The conferees expect that the Secretary of the Treasury will issue guidance establishing one or more safe harbor methods for the estimation of inventory shrinkage that will be deemed to result in a clear reflection of income, provided such safe harbor method is consistently applied and the taxpayer's inventory methods

otherwise satisfy the clear reflection of income standard.

Safe harbors applicable to retail trade.—In the case of taxpayers primarily engaged in retail trade (the resale of personal property to the general public), where physical inventories are normally taken at each location at least annually, the conferees anticipate that a safe harbor method will be established that will use a historical ratio of shrinkage to sales, multiplied by total sales between the date of the last physical inventory and year-end. This historical ratio is based on the actual shrinkage established by all physical inventories taken during the most recent three taxable years and the sales for related periods. The historical ratio should be separately determined for each store or department in a store of the taxpayer. The historical ratio, or estimated shrinkage determined using the historical ratio, cannot be adjusted by judgmental or other factors (e.g., floors or caps). The conferees expect that estimated shrinkage determined in accordance with the consistent application of the safe harbor method will not be required to be recalculated, through a lookback adjustment or otherwise, to reflect the results of physical inventories taken after year-end.

In the case of a new store or department in a store that has not verified shrinkage by a physical inventory in each of the most recent three taxable years, the historical ratio is the average of the historical ratios of the retailer's other stores or departments. Retailers using last in, first out (LIFO) methods of inventory are expected to be required to allocate shrinkage among their various inventory pools in a reasonable and consistent manner.

The conferees expect that procedures will be provided allowing an automatic election of such method of accounting for a taxpayer's first taxable year ending after the date of enactment. Any adjustment required by section 481 as a result of the change in method of accounting generally will be taken into account over a period of four years.

[¶ 10,840] Act Sec. 962. Law at ¶ 5053. CCH Explanation at ¶ 347.

Other Miscellaneous Provisions

House Committee Report

[*Workmen's compensation liability: Personal injury assignments*]

Treatment of workmen's compensation liability under rules for certain personal injury liability assignments.—The provision extends the exclusion for qualified assignments under Code section 130 to amounts assigned for assuming a liability to pay compensation under any workmen's compensation act. The provision requires that the assignee assume the liability from a person who is a party to the workmen's compensation claim, and requires that the periodic payment be excludable from the recipient's gross income under section 104(a)(1), in addition to the requirements of present law.

Effective date.—The provision is effective for workmen's compensation claims filed after the date of enactment.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 10,845] Act Sec. 963. Law at ¶ 5171. CCH Explanation at ¶ 601.

Other Miscellaneous Provisions

House Committee Report

[*Tax-exempt compensation companies*]

Tax-exempt status for certain State workmen's compensation act companies.—The provision clarifies the tax-exempt status of any organization that is created by State law, and organized and operated exclusively to provide workmen's compensation insurance and related coverage that is incidental to workmen's compensation insurance,[65] and that meets certain additional requirements. The workmen's compensation insurance must be required by State law, or be insurance with respect to which State law provides significant disincentives if it is not purchased by an employer (such as loss of exclusive remedy or forfeiture of affirmative defenses such as contributory negligence). The organization must provide workmen's compensation to any employer in the State (for employees in the State or temporarily assigned out-of-State) seeking such insurance and meeting other reasonable requirements. The State must either extend its full faith and credit to debt of the organization or provide the initial operating

[65] Related coverage that is incidental to workmen's compensation insurance includes liability under Federal workmen's compensation laws, for example.

capital of such organization. For this purpose, the initial operating capital can be provided by providing the proceeds of bonds issued by a State authority; the bonds may be repaid through exercise of the State's taxing authority, for example. For periods after the date of enactment, the assets of the organization must revert to the State upon dissolution. Finally, the majority of the board of directors (or comparable oversight body) of the organization must be appointed by an official of the executive branch of the State or by the State legislature, or by both.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997. No inference is intended as to the status of such organizations under present law.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill. The Senate Finance committee report clarifies that related coverage that is incidental to workmen's compensation insurance includes liability under Federal workmen's compensation laws, the Jones Act, and the Longshore and Harbor Workers Compensation Act, for example. The Senate Finance committee report also clarifies that many organizations described in the provision have been operating as tax-exempt organizations. No inference is intended that organizations described in the provision are not tax-exempt under present law.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment with modifications.

The conference agreement modifies the full-faith-and-credit portion of the requirement that the State must extend its full faith and credit to debt of the organization (or provide the initial operating capital of such organization). Under the conference agreement, the State must extend its full faith and credit to the initial debt of the organization.

The conference agreement also modifies the requirement relating to reversion of assets to the State upon dissolution. The conference agreement requires that, in the case of periods after the date of enactment, either the assets of the organization must revert to the State upon dissolution, or State law must not permit the dissolution of the organization, absent an act of the State legislature. Should dissolution of the organization become permissible under applicable State law, then the requirement that the assets of the organization revert to the State upon dissolution applies.

Many organizations described in the provision have been operating as organizations that are exempt from tax (e.g., as an organization that is exempt from tax because it is serving an essential governmental function of a State). No inference is intended that organizations described in the provision are not exempt from tax under present law. In addition, no inference is intended that the benefit plans of such organizations are not properly maintained by the organization. It is anticipated that Federal regulatory agencies will take appropriate action to address transition issues faced by organizations to conform to their benefit plans under the provision. For example, it is intended that an organization that has been maintaining a section 457 plan as an agency or instrumentality of a State could (without creating any inference with respect to present-law treatment) freeze future contributions to the section 457 plan and establish a retirement arrangement (e.g., a section 401(k) plan) that is consistent with the treatment of the organization as a tax-exempt employer under the provision.

[¶ 10,850] Act Sec. 964. Law at ¶ 5749. CCH Explanation at ¶ 401.

Other Miscellaneous Provisions

Senate Committee Report

[*Publicly traded partnership exception*]

Election to continue exception from treatment of publicly traded partnerships as corporations.— In the case of an existing publicly traded partnership that elects under the provision to be subject to a tax on gross income from the active conduct of a trade or business, the rule of present law treating a publicly traded partnership as a corporation does not apply. An existing publicly traded partnership is any publicly traded partnership that is not treated as a corporation, so long as such treatment is not determined under the passive-type income exception of Code section 7704(c)(1). The election to be subject to the tax on gross trade or business income, once made, remains in effect until revoked by the partnership, and cannot be reinstated.

The tax is 3.5 percent of the partnership's gross income from the active conduct of a trade or business. The partnership's gross trade or business income includes its share of gross trade or business income of any lower-tier partnership. The tax imposed under the provision may not be offset by tax credits.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment, with technical modifications. The conference agreement clarifies that the provision applies to any electing 1987 partnership, which means any publicly traded partnership, if (1) it is an existing partnership within the meaning of section 10211(c)(2) of the 1987 Act, (2) it has not been treated as a corporation for taxable years beginning after December 31, 1987, and before January 1, 1998 (and would not have been treated as a corporation even without regard to section 7704(c), the exception for partnerships with "passive-type" income), and (3) the partnership elects under the provision to be subject to a tax on gross income from the active conduct of a trade or business. An electing 1987 partnership ceases to be treated as such as of the first day after December 31, 1997, on which there has been the addition of a substantial new line of business with respect to the partnership.

[¶ 10,855] Act Sec. 965. Law at ¶ 5175. CCH Explanation at ¶ 611.

Other Miscellaneous Provisions

House Committee Report

[*UBIT: Corporate sponsorship payments*]

Exclusion from UBIT for certain corporate sponsorship payments.—Under the bill, qualified sponsorship payments received by a tax-exempt organization (or State college or university described in section 511(a)(2)(B)) are exempt from the UBIT.

"Qualified sponsorship payments" are defined as any payment made by a person engaged in a trade or business with respect to which the person will receive no substantial return benefit other than the use or acknowledgment of the name or logo (or product lines) of the person's trade or business in connection with the organization's activities.[69] Such a use or acknowledgment does *not* include advertising of such person's products or services—meaning qualitative or comparative language, price information or other indications of savings or value, or an endorsement or other inducement to purchase, sell, or use such products or services. Thus, for example, if, in return for receiving a sponsorship payment, an organization promises to use the sponsor's name or logo in acknowledging the sponsor's support for an educational or fundraising event conducted by the organization, such payment will not be subject to the UBIT. In contrast, if the organization provides advertising of a sponsor's products, the payment made to the organization by the sponsor in order to receive such advertising will be subject to the UBIT (provided that the other, present-law requirements for UBIT liability are satisfied).

The bill specifically provides that a qualified sponsorship payment does not include any payment where the amount of such payment is contingent, by contract or otherwise, upon the level of attendance at an event, broadcast ratings, or other factors indicating the degree of public exposure to an activity. However, the fact that a sponsorship payment is contingent upon an event actually taking place or being broadcast, in and of itself, will not cause the payment to fail to be a qualified sponsorship payment. Moreover, mere distribution or display of a sponsor's products by the sponsor or the tax-exempt organization to the general public at a sponsored event, whether for free or for remuneration, will be considered to be "use or acknowledgment" of the sponsor's product lines (as opposed to advertising), and thus will not affect the determination of whether a payment made by the sponsor is a qualified sponsorship payment.

The provision does not apply to the sale of advertising or acknowledgments in tax-exempt organization periodicals. For this purpose, the term "periodical" means regularly scheduled and printed material published by (or on behalf of) the payee organization that is not related to and primarily distributed in connection with a specific event conducted by the payee organization. For example, the provision will not apply to payments that lead to acknowledgments in a monthly journal, but will apply if a sponsor receives an acknowledgment in a program or brochure distributed at a sponsored event.

The provision specifically provides that, to the extent that a portion of a payment would (if made as a separate payment) be a qualified sponsorship payment, such portion of the payment will be treated as a separate payment. Thus, if a sponsorship payment made to a tax-exempt organization entitles the sponsor to both product advertising *and* use or acknowledgment of the sponsor's name or logo by the organization, then the UBIT will not apply to the amount of such payment that exceeds the fair market value of the product advertising provided to the sponsor. Moreover, the provision of facilities, services or other privileges by an exempt organization to a sponsor or the sponsor's designees (e.g., complimentary tickets, pro-am playing spots in golf tournaments, or receptions for major donors) in connection with a

[69] In determining whether a payment is a qualified sponsorship payment, it is irrelevant whether the sponsored activity is related or unrelated to the organization's exempt purpose.

sponsorship payment will not affect the determination of whether the payment is a qualified sponsorship payment. Rather, the provision of such goods or services will be evaluated as a separate transaction in determining whether the organization has unrelated business taxable income from the event. In general, if such services or facilities do not constitute a substantial return benefit or if the provision of such services or facilities is a related business activity, then the payments attributable to such services or facilities will not be subject to the UBIT. Moreover, just as the provision of facilities, services or other privileges by a tax-exempt organization to a sponsor or the sponsor's designees (complimentary tickets, pro-am playing spots in golf tournaments, or receptions for major donors) will be treated as a separate transaction that does not affect the determination of whether a sponsorship payment is a qualified sponsorship payment, a sponsor's receipt of a license to use an intangible asset (e.g., trademark, logo, or designation) of the tax-exempt organization likewise will be treated as separate from the qualified sponsorship transaction in determining whether the organization has unrelated business taxable income.

The exemption provided by the provision will be in addition to other present-law exceptions from the UBIT (e.g., the exceptions for activities substantially all the work for which is performed by volunteers and for activities not regularly carried on). No inference is intended as to whether any sponsorship payment received prior to 1998 was subject to the UBIT.

Effective date.—The provision applies to qualified sponsorship payments solicited or received after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and Senate amendment, except that the conference agreement clarifies that the qualified sponsorship payment provision does not apply to payments that entitle the payor to the use or acknowledgment of the payor's trade or business name or logo (or product lines) in tax-exempt organization periodicals. Similarly, the qualified sponsorship payment provision does not apply to payments made in connection with "qualified convention or trade show activities," as defined in present-law section 513(d)(3). Such payments are outside the qualified sponsorship payment provision's safe-harbor exclusion, and, therefore, will be governed by present-law rules that determine whether the payment is subject to the UBIT. Thus, for example, payments that entitle the payor to a depiction of the payor's name or logo in a tax-exempt organization periodical may or may not be subject to the UBIT depending on the application of present-law rules regarding periodical advertising and nontaxable donor recognition.[45]

As a further clarification, the conferees intend that, as provided under Prop. Treas. Reg. sec. 1.513-4, the use of promotional logos or slogans that are an established part of the sponsor's identity would not, by itself, constitute advertising for purposes of determining whether a payment is a qualified sponsorship payment.

[¶ 10,860] Act Sec. 966. Law at ¶ 5177. CCH Explanation at ¶ 616.

Other Miscellaneous Provisions

Senate Committee Report

[*Timeshare associations*]

Timeshare associations.—The bill amends section 528 to permit timeshare associations to qualify for taxation under that section. Timeshare associations would have to meet the requirements of section 528 (e.g., the 60 percent gross income, 90 percent expenditure, and the non-profit organizational and operational requirements). Timeshare associations electing to be taxed under section 528 are subject to a tax on their "timeshare association income" at a rate of 32 percent.

60-percent test.—A qualified timeshare association must receive at least 60 percent of its income from membership dues, fees and assessments from owners of either (a) timeshare rights to use of, or (b) timeshare ownership in, property the timeshare association.

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[45] For guidance regarding the treatment of periodical advertising under the UBIT, see section 513(c); *United States v. American College of Physicians*, 475 U.S. 834 (1986); Treas. Reg. 1.513-1(d)(4)(iv), Example 7; Rev. Rul. 82-139, 1982-2 C.B. 108; Rev. Rul. 74-38, 1974-1 C.B. 144; PLR 9137049; and PLR 9234002. For guidance regarding the treatment of donor acknowledgments under the UBIT, see Rev. Rul. 76-93, 1976-1 C.B. 170; PLR 8749085; and PLR 9044071. In the interest of administrative convenience, the conferees encourage the Treasury Department to permit tax-exempt entities to provide combined reporting of payments that are both qualified sponsorship payments and nontaxable payments made in exchange for donor acknowledgments in a periodical or in connection with a qualified convention or trade show. In addition, to the extent tax-exempt entities are required to allocate portions of payments, the conferees encourage the Treasury Department to minimize the reporting burden associated with any such allocation.

90-percent test.—At least 90 percent of the expenditures of the timeshare association must be for the acquisition, management, maintenance, or care of "association property," and activities provided by the association to, or on behalf of, members of the timeshare association. "Activities provided to or on behalf of members of the [timeshare] association" includes events located on association property (*e.g.*, member's meetings at the association's meeting room, parties at the association's swimming pool, golf lessons on association's golf range, transportation to and from association property, etc.).

Organizational and operational tests.—No part of the net earnings of the timeshare association can inure to the benefit (other than by acquiring, constructing, or providing management, maintenance, and care of property of the timeshare association or rebate of excess membership dues, fees, or assessments) of any private shareholder or individual. A member of a qualified timeshare association must hold a timeshare right to use (or timeshare ownership in) real property of the association. Property of a timeshare association includes property in which a timeshare association or members of the association have rights arising out of recorded easements, covenants, and other recorded instruments to use property related to the timeshare project. A qualified timeshare association cannot be a condominium management association. Lastly, the timeshare association must elect to be taxed under section 528.

Effective date.—The provision is effective for taxable years beginning after December 31, 1996.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 10,865] Act Sec. 967. Law at ¶ 7015A. CCH Explanation at ¶ 351.

Other Miscellaneous Provisions

House Committee Report (Related Non-Code Provision)

[*Virgin Islands tax-exempt bonds*]

Modification of advance refunding rules for certain tax-exempt bonds issued by the Virgin Islands.—One additional advance refunding would be allowed for governmental bonds issued by the Virgin Islands that were advance refunded before June 9, 1997, if the Virgin Islands debt provisions are changed to repeal the current priority first lien requirement.

Effective date.—The provision is effective on the date of enactment.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 10,870] Act Sec. 968. Law at ¶ 5331. CCH Explanation at ¶ 369.

Other Miscellaneous Provisions

House Committee Report

[*Farmers' cooperatives*]

Deferral of gain on certain sales of farm product refiners and processors.—The bill extends the deferral provided under section 1042 to the sale of stock of a qualified refiner or processor to an eligible farmer's cooperative. A qualified refiner or processor is a domestic corporation substantially all of the activities of which consist of the active conduct of the trade or business of refining or processing agricultural or horticultural products and which purchases more than one-half of such products to be refined or processed from farmers who make up the cooperative which is purchasing the stock or the cooperative. An eligible farmers' cooperative is an organization which is treated as a cooperative for Federal income tax purposes and which is engaged in the marketing of agricultural or horticultural products.

The deferral of gain is available only if, immediately after the sale, the eligible farmers' cooperative owns 100 percent of the qualified refiner or processor. The provision applies even if the stock of the qualified refiner or processor is publicly traded. In addition, the bill applies to gain on the sale of stock by a C corporation.

Effective date.—The provision applies to sales after December 31, 1997.

Conference Committee Report

The conference agreement follows the House bill, with the modification that the requirement that the refiner or processor purchase more than one-half of the products to be refined or processed from farmers who make up the cooperative which is purchasing the stock or the cooperative must be satisfied for at least one year prior to the sale.

[¶ 10,875] Act Sec. 969. Law at ¶ 5103. CCH Explanation at ¶ 111.

Other Miscellaneous Provisions

House Committee Report

[*Business meal expense deduction*]

Increased deduction for business meals while operating under Department of Transportation hours of service limitations.—The bill increases to 80 percent the deductible percentage of the cost of food and beverages consumed while away from home by an individual during, or incident to, a period of duty subject to the hours of service limitations of the Department of Transportation. The increase in the deductible percentage is phased in according to the following schedule:

Taxable years beginning in	*Deductible Percentage*
1998, 1999	55 percent
2000, 2001	60 percent
2002, 2003	65 percent
2004, 2005	70 percent
2006, 2007	75 percent
2008 and thereafter	80 percent

Effective date.—The provision is effective for taxable years beginning after 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 10,880] Act Sec. 970. Law at ¶ 5055. CCH Explanation at ¶ 332.

Other Miscellaneous Provisions

Senate Committee Report

[*Deductibility of meals: Employer's convenience*]

Deductibility of meals provided for the convenience of the employer.—The bill provides that meals that are excludable from employees' incomes because they are provided for the convenience of the employer pursuant to section 119 of the Code are excludable as a de minimis fringe benefit and therefore are fully deductible by the employer. No inference is intended as to whether such meals are fully deductible under present law.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment as to meals provided pursuant to section 119. Because food and beverages consumed by workers at these specified remote seafood processing facilities are provided for the convenience of the employer pursuant to section 119 and therefore will be deductible under the Senate amendment provision as to meals provided pursuant to section 119 (provided they satisfy the relevant section 132 requirements), the conference agreement does not include the Senate amendment provision relating to remote seafood processors because it is subsumed by the section 119 provision.

[¶ 10,885] Act Sec. 971. Law at ¶ 5109. CCH Explanation at ¶ 327.

Other Miscellaneous Provisions

House Committee Report

[*Incremental cost of clean fuel vehicle exempt from depreciation limits*]

Exemption of the incremental cost of a clean fuel vehicle from the limits on depreciation for vehicles.—The bill modifies the section 280F limitation on depreciation in the case of qualified clean-burning fuel vehicles and certain electric vehicles. With respect to qualified clean-burning fuel vehicles, those that are modified to permit such vehicle to be propelled by a clean burning fuel, the bill generally modifies present-law by applying the current limitation to that portion of the vehicles cost not represented by the installed qualified clean-burning fuel property. The tax-

payer may claim an amount otherwise allowable as a depreciation deduction on the installed qualified clean-burning fuel, without regard to the 280F limitation. Generally, this has the same effect as only subjecting the cost of the vehicle before modification to the sec. 280F limitations.

For example, assume that in 1997, after the date of enactment, a taxpayer purchases a clean-burning fuel vehicle for $43,000. Further assume that had the taxpayer purchased the identical vehicle, without having had certain components replaced to qualify it as clean burning, the price paid would have been $39,000. The cost of the qualified retrofit parts and components is $4,000. The depreciation that the taxpayer may claim for this vehicle in any year is the depreciation that could be claimed under present law section 280F for that portion of the vehicle worth $39,000, plus the depreciation that can be claimed under section 168 for the $4,000 worth of qualified retrofit parts and components.

In the case of a passenger vehicle designed to be propelled primarily by electricity and built by an original equipment manufacturer, the base-year limitation amounts of $2,560 for the first taxable year in the recovery period, $4,100 for the second taxable year in the recovery period, $2,450 for the third taxable year in the recovery period, and $1,475 for each succeeding taxable year in the recovery period are tripled to $7,680, $12,300, $7,350, and $4,425, respectively, and then adjusted for inflation after October 1987 by the automobile component of the Consumer Price Index.

Effective date.—The provision is effective for property placed in service on or after the date of enactment and before January 1, 2005.

Conference Committee Report

The conference agreement follows the House bill, with a modification to the effective date that provides that the provision is effective for property placed in service after the date of enactment and before January 1, 2005.

[¶ 10,890] Act Sec. 972. Law at ¶ 5191. CCH Explanation at ¶ 326.

Other Miscellaneous Provisions

House Committee Report

[*Income tax limit on percentage depletion for marginal production*]

Temporary suspension of taxable income limit on percentage depletion for marginal production.—The 65-percent-of-net-income limitation is suspended for domestic oil and gas production from marginal properties during taxable years beginning after December 31, 1997, and before January 1, 2000.

Effective date.—The provision is effective on the date of enactment.

Senate Committee Report

Suspension of net income property limitation for production from marginal wells.—The 100-percent-of-net-income property limitation does not apply for any taxable year beginning in a calendar year in which the annual average wellhead price per barrel for crude oil (within the meaning of section 29(d)(2)(C)) is below $14 per barrel.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

The 100-percent-of-net-income property limitation is suspended for domestic oil and gas production from marginal properties during taxable years beginning after December 31, 1997, and before January 1, 2000.

Effective date.—The provision is effective on the date of enactment. [Note: under Act Sec. 972(b) of H.R. 2014, the provision applies to taxable years beginning after December 31, 1997.—CCH].

[¶ 10,895] Act Sec. 973. Law at ¶ 5077. CCH Explanation at ¶ 107.

Other Miscellaneous Provisions

Senate Committee Report

[*Charitable deduction computation: Standard mileage rate*]

Increase in standard mileage rate for purposes of computing charitable deduction.—The bill increases this mileage rate to 15 cents per mile. This rate is indexed for inflation, rounded down to the nearest whole cent.

Effective date.—The increase to 15 cents is effective for taxable years beginning after December 31, 1997. The indexation is effective for inflation occurring after 1997. Accordingly, the first adjustment for indexing will occur in 1999 to reflect inflation in 1998.

Conference Committee Report

The conference agreement increases this mileage rate to 14 cents per mile (not indexed for inflation), effective for taxable years beginning after December 31, 1997.

[¶ 10,915] Act Sec. 974. Law at ¶ 5171. CCH Explanation at ¶ 605.

Other Miscellaneous Provisions

Senate Committee Report

[*Hospital cooperative service organizations: Receivables*]

Purchasing of receivables by tax-exempt hospital cooperative service organizations.—The bill clarifies that, for purposes of section 501(e), billing and collection services include the purchase of patron accounts receivable on a recourse basis. Thus, hospital cooperative service organizations are permitted to advance cash on the basis of member accounts receivable, provided that each member hospital retains the risk of non-payment with respect to its accounts receivable.

Effective date.—The provision is effective for taxable years beginning after December 31, 1996. No inference is intended with respect to taxable years prior to the effective date.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 10,920] Act Sec. 975. Law at ¶ 5037. CCH Explanation at ¶ 117.

Other Miscellaneous Provisions

Senate Committee Report

[*Business expenses deduction*]

Provide above-the-line deduction for certain business expenses.—Under the bill, employee business expenses relating to service as an official of a State or local government (or political subdivision thereof) are deductible in computing AGI ("above the line"), provided the official is compensated in whole or in part on a fee basis. Consequently, such expenses are also deductible for minimum tax purposes.

Effective date.—The provision applies to expenses paid or incurred in taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment.

Effective date.—The conference agreement is effective with respect to expenses paid or incurred in taxable years beginning after December 31, 1986.

[¶ 10,925] Act Sec. 976. Law at ¶ 5613 and 7016. CCH Explanation at ¶ 1064.

Other Miscellaneous Provisions

Senate Committee Report (Code and Related Non-Code Provisions)

[*Employment tax reporting project*]

Combined employment tax reporting demonstration project.—The bill permits implementation of a demonstration project to assess the feasibility and desirability of expanding combined reporting in the future. There are several limitations on the demonstration project. First, it is limited to the State of Montana and the IRS. Second, it is limited to employment tax reporting. Third, it is limited to disclosure of the name, address, TIN, and signature of the taxpayer, which is information common to both the Montana and Federal portions of the combined form. Fourth, it is limited to a period of five years.

Effective date.—The provision is effective on the date of enactment, and will expire on the date five years after the date of enactment.

Conference Committee Report

The conference agreement follows the Senate amendment, with a technical modification providing a cross-reference to the provision in section 6103 of the Code.

[¶ 10,930] Act Sec. 977. Law at ¶ 7019. CCH Explanation at ¶ 565.

Miscellaneous Provisions—Excise Tax

Conference Committee Report (Related Non-Code Provision)

[*Intercity Passenger Rail Fund*]

Senate [Floor] Amendment.—The Senate amendment dedicates net revenues from 0.5 cent per gallon of the 4.3-cents-per gallon transportation motor fuels excise tax to a new Intercity Passenger Rail Fund ("Rail Fund") to finance capital improvements of National Railroad Passenger Corporation (Amtrak) and certain transportation activities in States not receiving Amtrak service. Dedicated revenues are those from fuels taxes imposed from October 1, 1997 through April 15, 2001.

The Senate amendment also expands the purposes for which non-Amtrak States may use Rail Fund monies to include: (1) local transit needs such as transportation for the elderly and handicapped; (2) rail/highway crossing safety projects (generally financed through the Highway Trust Fund); (3) certain capital expenditures of smaller freight railroads; and (4) certain rural airport capital expenditures.

Amounts received from the Rail Fund are not included in income. No tax deduction or addition to basis is allowed by the recipient with respect to expenditure of the amount.

Rail Fund spending is subject to appropriation, and is provided for under provisions of the Fiscal Year 1998 Budget Resolution.

Effective date.—The provision is effective on the date of enactment.

Conference Agreement.—The conference agreement follows the approach of the Senate amendment with modifications. The conference agreement provides elective procedures that allows Amtrak to consider the tax attributes of its predecessors, those railroads that were relieved of their responsibility to provide intercity rail passenger service as a result of the Rail Passenger Service Act of 1970, in the use of its net operating losses. The benefit allowable under these procedures is limited to the least of: (1) 35 percent of Amtrak's existing qualified carryovers, (2) the net tax liability for the carryback period, or (3) $2,323,000,000. One half of the amount so calculated will be treated as a payment of the tax imposed by chapter 1 of the Internal Revenue Code of 1986 for each of the first two taxable years ending after the date of enactment.

The existing qualified carryovers are the net operating loss carryovers that are available under section 172(b) in Amtrak's first taxable year ending after September 30, 1997. The net tax liability for the carryback period is the aggregate of the net tax liability of Amtrak's railroad predecessors for all taxable years beginning before January 1, 1971, for which there is a net Federal tax liability. Amtrak's railroad predecessors are those railroads that were relieved of their responsibility to provide intercity rail passenger service as a result of the Rail Passenger Service Act of 1970, and their predecessors. In the case of a railroad predecessor who joined in the filing of a consolidated tax return, the net tax liability of the predecessor will be the net tax liability of the consolidated group.

The net operating losses of Amtrak are required to be reduced by an amount equal to the amount obtained by Amtrak under this provision, divided by 0.35. The Secretary of the Treasury is to adjust, as he deems appropriate, the tax account of each predecessor railroad for the carryback period to reflect the utilization of the net operating losses. The amount of the adjustment is equal to the amount of the benefit and is to be taken into consideration on the tax accounts of the predecessor railroads on a first-in, first-out basis, starting with balances for the earliest year for which any predecessor railroad has a net tax liability. No additional refund to any taxpayer other than Amtrak is to be allowed as a result of these adjustments.

The availability of the elective procedures is conditioned on Amtrak (1) agreeing to make payments of one percent (1%) of the amount it receives to each of the non-Amtrak States to offset certain transportation related expenditures and (2) using the balance for certain qualified expenses. Non-Amtrak States are those States that are not receiving Amtrak service at any time during the period beginning on the date of enactment and ending on the date of payment.

No deduction is allowed with respect to any qualified expense whose payment is attributable to the proceeds made available as a result of this provision. The basis of any property must be reduced by the portion of its cost that is attributable to such proceeds. An item of cost or expense is attributable to such proceeds if it is (1) paid from the proceeds of the refund or (2) to the extent the principal and interest of any borrowings are paid from the proceeds of the refund, from the proceeds of such borrowings.

Amtrak's earnings and profits will be increased by the amount of the refund. However, the confer-

ees expect that this amount will not be included in adjusted current earnings for alternative minimum tax purposes, consistent with Treas. Reg. sec. 1.56(g)-1(c)(4) (ii).

Effective date.—The provision is effective on the date of enactment. However, no refund shall be made as a result of this provision earlier than the date of enactment of Federal legislation which authorizes reforms of Amtrak. No interest shall accrue with respect to the payment of any refund until 45 days after the later of (1) the enactment of such reform legislation, or (2) the filing by Amtrak of a Federal income tax return which includes the election to use the procedures described in this provision.

[¶ 10,945] Act Sec. 981. Law at ¶ 7022. CCH Explanation at ¶ 993.

Miscellaneous Provisions

House Committee Report (Related Non-Code Provision)

[*Generalized system of preferences*]

Extension of duty-free treatment under generalized system of preferences.—

Generalized system of preferences.—The bill reauthorizes the GSP program for two years, to expire on May 31, 1999. The bill provides for refunds, upon request of the importer, of any duty paid between May 31, 1997, and the date of enactment.

Effective date.—The provision is effective upon date of enactment.

Conference Committee Report

The conference agreement follows the House bill, with a modification to extend the GSP reauthorization through June 30, 1998.

[¶ 11,115] Act Sec. 1001(a). Law at ¶ 5355. CCH Explanation at ¶ 308, 309, 310, 311 and 312.

Revenue-Increase Provisions—Financial Products

Senate Committee Report

[*Appreciated financial positions*]

Require recognition of gain on certain appreciated positions in personal property.—

General rule.—The bill requires a taxpayer to recognize gain (but not loss) upon entering into a constructive sale of any appreciated position in stock, a partnership interest or certain debt instruments as if such position were sold, assigned or otherwise terminated at its fair market value on the date of the constructive sale.

If the requirements for a constructive sale are met, the taxpayer would recognize gain in a constructive sale as if the position were sold at its fair market value on the date of the sale and immediately repurchased. Except as provided in Treasury regulations, a constructive sale would generally not be treated as a sale for other Code purposes. An appropriate adjustment in the basis of the appreciated financial position would be made in the amount of any gain realized on a constructive sale, and a new holding period of such position would begin as if the taxpayer had acquired the position on the date of the constructive sale.

A taxpayer is treated as making a constructive sale of an appreciated position when the taxpayer (or, in certain circumstances, a person related to the taxpayer) does one of the following: (1) enters into a short sale of the same property, (2) enters into an offsetting notional principal contract with respect to the same property, or (3) enters into a futures or forward contact to deliver the same property. A constructive sale under any part of the definition occurs if the two positions are in property that, although not the same, is substantially identical. In addition, in the case of an appreciated financial position that is a short sale, a notional principal contract or a futures or forward contract, the holder is treated as making a constructive sale when it acquires the same property as the underlying property for the position. Finally, to the extent provided in Treasury regulations, a taxpayer is treated as making a constructive sale when it enters into one or more other transactions, or acquires one or more other positions, that have substantially the same effect as any of the transactions described.

The positions of two related persons are treated as together resulting in a constructive sale if the relationship is one described in section 267 or section 707(b) and the transaction is entered into with a view toward avoiding the purposes of the provision.

Whether any part of the constructive sale definition is met by one or more appreciated financial positions and offsetting transactions generally will be determined as of the date the last of such

positions or transactions is entered into. More than one appreciated financial position or more than one offsetting transaction can be aggregated to determine whether a constructive sale has occurred. For example, it is possible that no constructive sale would result if one appreciated financial position and one offsetting transaction were considered in isolation, but that a constructive sale would result if the appreciated financial position were considered in combination with two transactions. Where the standard for a constructive sale is met with respect to only a *pro rata* portion of a taxpayer's appreciated financial position (e.g., some, but not all, shares of stock), that portion would be treated as constructively sold under the provision. If there is a constructive sale of less than all of any type of property held by the taxpayer, the specific property deemed sold would be determined under the rules governing actual sales, after adjusting for previous constructive sales under the bill. Under the regulations to be issued by the Treasury, either a taxpayer's appreciated financial position or its offsetting transaction might in some circumstances be disaggregated on a non-*pro rata* basis for purposes of the constructive sale determination.

The bill provides an exception from constructive sale treatment for any transaction that is closed before the end of the 30th day after the close of the taxable year in which it was entered into. This exception does not apply, however, where a transaction is closed during the last 60 days of the taxable year or within 30 days thereafter (the "90-day period") unless (1) the taxpayer holds the appreciated financial position to which the transaction relates (e.g., the stock where the offsetting transaction is a short sale) throughout the 60-day period beginning on the date the transaction is closed and (2) at no time during such 60-day period is the taxpayer's risk of loss reduced (under the principles of section 246(c)(4)) by holding positions with respect to substantially similar or related property. These requirements do not apply to a transaction that is closed during the 90-day period where a similar transaction is reopened during such period, so long as the reopened transaction is closed during the 90-day period and the requirements of the previous sentence are met after such closing.

A transaction that has resulted in a constructive sale of an appreciated financial position (e.g., a short sale) is not treated as resulting in a constructive sale of another appreciated financial position so long as the taxpayer holds the position which was treated as constructively sold. However, when that position is assigned, terminated or disposed of by the taxpayer, the taxpayer immediately thereafter is treated as entering into the transaction that resulted in the constructive sale (e.g., the short sale) if it remains open at that time. Thus, the transaction can cause a constructive sale of another appreciated financial position at any time thereafter. For example, assume a taxpayer holds two appreciated stock positions and one offsetting short sale, and the taxpayer identifies the short sale as offsetting one of the stock positions. If the taxpayer then sells the stock position that was identified, the identified short position would cause a constructive sale of the taxpayer's other stock position at that time.

Definitions.—An appreciated financial position is defined as any position with respect to any stock, debt instrument, or partnership interest, if there would be gain upon a taxable disposition of the position for its fair market value. A "position" is defined as an interest, including a futures or forward contract, short sale, or option. An exception is provided for debt instruments that are not convertible and the interest on which is either fixed, payable at certain variable rates (Treas. reg. sec. 1.860G-1(a)(3)) or is based on certain interest payments on a pool of mortgages. Other debt instruments, including those identified as part of a hedging or straddle transaction, are appreciated financial positions.

A notional principal contract is treated as an offsetting notional principal contract, and thus, results in a constructive sale of an appreciated financial position, if it requires the holder of the appreciated financial position to pay (or provide a contractual credit for) all or substantially all of the investment yield and appreciation on the position for a specified period and also gives the holder a right to be reimbursed for (or receive credit for) all or substantially all of any decline in value of the position.

A forward contract results in a constructive sale of an appreciated financial position only if the forward contract provides for delivery of a substantially fixed amount of property and a substantially fixed price. Thus, a forward contract providing for delivery of an amount of property, such as shares of stock, that is subject to significant variation under the contract terms does not result in a constructive sale.

A constructive sale does not include a transaction involving an appreciated financial position that is marked to market, including positions governed by section 475 (mark to market for securities dealers) or section 1256 (mark to market for futures contracts, options and currency contracts). Nor does a constructive sale include any contract for sale of an appreciated financial position which is not a "marketable security" (as defined in section 453(f))) if the contract settles within one year after the date it is entered into.

Treasury guidance.—The bill provides regulatory authority to the Treasury to treat as constructive sales certain transactions that have substantially the same effect as those specified (i.e., short sales, offsetting notional principal con-

tracts and futures or forward contracts to deliver the same or substantially similar property).

It is anticipated that the Treasury will use the provision's authority to treat as constructive sales other financial transactions that, like those specified in the provision, have the effect of eliminating substantially all of the taxpayer's risk of loss and opportunity for income or gain with respect to the appreciated financial position. Because this standard requires reduction of both risk of loss and opportunity for gain, it is intended that transactions that reduce only risk of loss or only opportunity for gain will not be covered. Thus, for example, it is not intended that a taxpayer who holds an appreciated financial position in stock will be treated as having made a constructive sale when the taxpayer enters into a put option with an exercise price equal to the current market price (an "at the money" option). Because such an option reduces only the taxpayer's risk of loss, and not its opportunity for gain, the above standard would not be met.

For purposes of the provision, it is not intended that risk of loss and opportunity for gain be considered separately. Thus, if a transaction has the effect of eliminating a *portion* of the taxpayer's risk of loss and a *portion* of the taxpayer's opportunity for gain with respect to an appreciated financial position which, taken together, are substantially all of the taxpayer's risk of loss and opportunity for gain, it is intended that Treasury regulations will treat this transaction as a constructive sale of the position.

It is anticipated that the Treasury regulations, when issued, will provide specific standards for determining whether several common transactions will be treated as constructive sales. One such transaction is a "collar." In a collar, a taxpayer commits to an option requiring him to sell a financial position at a fixed price (the "call strike price") and has the right to have his position purchased at a lower fixed price (the "put strike price"). For example, a shareholder may enter into a collar for a stock currently trading at $100 with a put strike price of $95 and a call strike price of $110. The effect of the transaction is that the seller has transferred the rights to all gain above the $110 call strike price and all loss below the $95 put strike price; the seller has retained all risk of loss and opportunity for gain in the range price between $95 and $110. A collar can be a single contract or can be effected by using a combination of put and call options.

In order to determine whether collars have substantially the same effect as the transactions specified in the provision, it is anticipated that Treasury regulations will provide specific standards that take into account various factors with respect to the appreciated financial position, including its volatility. Similarly, it is expected that several aspects of the collar transaction will be relevant, including the spread between the put and call prices, the period of the transaction, and the extent to which the taxpayer retains the right to periodic payments on the appreciated financial position (e.g., the dividends on collared stock). The Committee expects that the Treasury regulations with respect to collars will be applied prospectively, except in cases to prevent abuse.

Another common transaction for which a specific regulatory standard may be appropriate is a so-called "in-the-money" option, i.e., a put option where the strike price is significantly above the current market price or a call option where the strike price is significantly below the current market price. For example, if a shareholder purchases a put option exercisable at a future date (a so-called "European" option) with a strike price of $120 with respect to stock currently trading at $100, the shareholder has eliminated all risk of loss on the position for the option period and assured himself of all gain on the stock for any appreciation up to $120. In determining whether such a transaction will be treated as a constructive sale, it is anticipated that Treasury regulations will provide a specific standard that takes into account many of the factors described above with respect to collars, including the yield and volatility of the stock and the period and other terms of the option.

For collars, options and some other transactions, one approach that Treasury might take in issuing regulations is to rely on option prices and option pricing models. The price of an option represents the payment the market requires to eliminate risk of loss (for a put option) and to purchase the right to receive yield and gain (for a call option). Thus, option pricing offers one model for quantifying both the total risk of loss and opportunity for gain with respect to an appreciated financial position, as well as the proportions of these total amounts that the taxpayer has retained.

In addition to setting specific standards for treatment of these and other transactions, it may be appropriate for Treasury regulations to establish "safe harbor" rules for common financial transactions that do not result in constructive sale treatment. An example might be a collar with a sufficient spread between the put and call prices, a sufficiently limited period and other relevant terms such that, regardless of the particular characteristics of the stock, the collar probably would not transfer substantially all risk of loss and opportunity for gain.

Effective date.—The provision is effective for constructive sales entered into after June 8, 1997. A special rule is provided for transactions before this date which would have been constructive sales under the provision. The positions in such a transaction will not be taken into account in determining whether a constructive sale after June

8, 1997, has occurred, provided that the taxpayer identifies the offsetting positions of the earlier transaction within 30 days after the date of enactment. The special rule will cease to apply on the date the taxpayer ceases to hold any of the offsetting positions so identified.

In the case of a decedent dying after June 8, 1997, if (1) a constructive sale of an appreciated financial position (as defined in the provision) occurred before such date, (2) the transaction remains open for not less than two years, and (3) the transaction is not closed in a taxable transaction within 30 days after the date of enactment, such position (and any property related to it, under the principles of the provision) will be treated as property constituting rights to receive income in respect of a decedent under section 691.

Conference Committee Report

The conference agreement follows the Senate amendment with the following modifications.

A trust instrument that is actively traded is generally treated as stock for purposes of determining whether the instrument is an appreciated financial position. The conference agreement provides that a trust instrument will not be treated as stock if substantially all (by value) of the property held by the trust is debt that qualifies for the exception to the definition of appreciated financial position for certain debt instruments. In addition, the conference agreement clarifies that only debt instruments that entitle the holder to receive an unconditional principal amount qualify for the exception.

The conference agreement modifies the exception to constructive sale treatment for transactions that are closed in the 90-day period ending with the 30th day after the close of the taxable year by applying similar requirements to all transactions closed prior to such day. Under the conference agreement, the exception is available only if, for the 60 days after closing a transaction, (1) the taxpayer holds the appreciated financial position and (2) at no time is the taxpayer's risk of loss reduced by holding certain other positions. If a transaction that is closed is reestablished in a substantially similar position, the exception applies provided that the reestablished position is closed prior to the end of the 30th day after the close of the taxable year and the above two requirements are met after such closing.

The conferees also wish to clarify some aspects of the application of the provision. The conferees do not intend that an agreement that is not a contract for purposes of applicable contract law will be treated as a forward contract. Thus, contingencies to which the contract is subject will generally be taken into account.

The conferees intend that the constructive sale provision generally will apply to transactions that are identified hedging or straddle transactions under other Code provisions (secs. 1092(a)(2), (b)(2) and (e), 1221 and 1256(e)). Where either position in such an identified transaction is an appreciated financial position and a constructive sale of such position results from the other position, the conferees intend that the constructive sale will be treated as having occurred immediately before the identified transaction. The constructive sale will not, however, prevent qualification of the transaction as an identified hedging or straddle transaction. Where, after the establishment of such an identified transaction, there is a constructive sale of either position in the transaction, gain will generally be recognized and accounted for under the relevant hedging or straddle provision. However, the conferees intend that future Treasury regulations may except certain transactions from the constructive sale provision where the gain recognized would be deferred under an identified hedging or straddle provision (*e.g.* Treas. reg. sec. 1.446-4(b)).

The conferees wish to clarify certain other aspects of the Treasury's regulatory authority under the provision. The conferees urge that the Treasury issue prompt guidance, including safe harbors, with respect to common transactions entered into by taxpayers.

The legislative history to both the House bill and the Senate amendment describe "collar" transactions and recommend that Treasury regulations provide standards for determining which collar transactions result in constructive sales. The conferees expect that these Treasury regulations with respect to collars will be applied prospectively, except in cases to prevent abuse.

The legislative history states that, under the regulations to be issued by the Treasury, either a taxpayer's appreciated financial position or an offsetting transaction may in certain circumstances be considered on a disaggregated basis for purposes of the constructive sale determination. The conferees wish to clarify that this authority is intended to be used only where such disaggregated treatment reflects the economic reality of the transaction and is administratively feasible. For example, one transaction for which disaggregated treatment might be appropriate is an equity swap that references a small group of stocks, where the transaction is entered into by a taxpayer owning only one of the stocks.

Effective date.—The conference agreement modifies the special rule for decedents dying after June 8, 1997, to require that a position be open at some time during the three-year period ending on the decedent's death. Thus, no amount will be treated as income in respect of a decedent under the rule unless this requirement is met, as well as the requirements that the transaction remains

open for not less than two years and that the transaction is not closed within 30 days after the date of enactment. Finally, the conference agreement modifies the special rule to provide that gain with respect to a position that accrues after the transaction is closed will not be included in income in respect of a decedent.[1]

[¶ 11,120] Act Sec. 1001(b). Law at ¶ 5169. CCH Explanation at ¶ 341.

Revenue-Increase Provisions—Financial Products

House Committee Report

[*Mark to market: Traders and dealers*]

Election of mark to market for securities traders and for traders and dealers in commodities.—The bill allows securities traders and commodities traders and dealers to elect application of the mark-to-market accounting rules, which apply only to securities dealers under present law. All securities held by an electing taxpayer in connection with a trade or business as a securities trader, and all commodities held by an electing taxpayer in connection with a trade or business as a commodities dealer or trader, are subject to mark-to-market treatment. The taxpayer is allowed to identify property not held in connection with its trade or business as not subject to the election. As for securities dealers under present law, gain or loss recognized by an electing taxpayer under the provision is ordinary gain or loss.

With respect to a commodities dealer, all of the provisions of present law section 475 apply as if commodities were securities. Commodities for purposes of the provision would include only commodities of a kind customarily dealt in on an organized commodities exchange. It is anticipated that Treasury regulations will provide that section 475(c)(4), which prevents a dealer from treating certain notional principal contracts and other derivative financial instruments as held for investment, will apply only to contacts and instruments referenced to commodities in the case of a commodities dealer.

For securities traders, some of the provisions of present law section 475 apply, but others that are specific to dealers do not. For example, because a securities trader does not hold inventory, the mark-to-market rules for inventory are not applicable to traders. In addition, securities that are not held in connection with the trade or business of a securities trader are excluded from mark-to-market treatment if the trader identifies the securities in the trader's records before the close of the day on which they are acquired under rules similar to those of section 475(b)(2) for dealers. The provisions applicable to securities traders apply to commodities traders as if commodities were securities.

The election is to be made separately with respect to the taxpayer's entire business as (1) a securities trader, (2) a commodities trader, or (3) a commodities dealer. Thus, a taxpayer that is both a commodities dealer and a securities trader may make the election with respect to one business, but not the other. The election will be made in the time and manner prescribed by the Secretary of the Treasury and will be effective for the taxable year for which it is made and all subsequent taxable years, unless revoked with the consent of the Secretary.

Effective date.—The provision would apply to taxable years of securities traders ending after the date of enactment. For a taxpayer making the election, the adjustments required under section 481 as a result of the change in accounting method are required to be taken into account ratably over a four-year period.

For elections made for the first taxable year ending after the date of enactment, the taxpayer must identify the securities or commodities to which the election will apply within 30 days of the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and Senate amendment with the following modifications.

The conference agreement clarifies that if a securities trader elects application of the provision, all securities held in connection with its trade or business will generally be subject to mark-to-market accounting. An exception is provided for securities that have no connection with activities as a trader and that are identified on the day acquired (or at such other times as provided in Treasury regulations). The conferees do not intend that an electing taxpayer can mark-to-market loans made to customers or receivables or debt instruments acquired from customers that are not received or acquired in connection with a trade or business as a securities trader. Because the conferees are concerned about issues of taxpayer selectivity, the conferees intend that an electing taxpayer must be able to demonstrate by

[1] A standard similar to that of Treas. reg. sec. 1.246-5 would be appropriate for determining whether the relationship between the stock held and the group of stocks shorted is sufficient for constructive sale purposes.

clear and convincing evidence that a security bears no relation to activities as a trader in order to be identified as not subject to the mark-to-market regime. Any security that hedges another security that is held in connection with the taxpayer's trade or business as a trader will be treated as so held. Any position that is properly subject to the mark-to-market regime will not be taken into account for purposes of the constructive sale rules of section 1259. Similar rules apply to commodities traders.

The conference agreement expands the definition of a commodity for purposes of the provision to include any commodity that is actively traded (within the meaning of section 1092(d)(1)), any option, forward contract, futures contract, short position, notional principal contract or derivative instrument that references such a commodity, and any other evidence of an interest in such a commodity. Also included are positions that hedge the listed items and that are identified by the taxpayer under rules similar to the rules for securities.

The conferees anticipate that Treasury regulations applying section 475(b)(4), which prevents a dealer from treating certain notional principal contracts and other derivative financial instruments as held for investment, will in the case of a commodities trader or dealer apply only to contracts and instruments referenced to commodities.

Effective date.—The conferees wish to clarify that the special rule with respect to the section 481 adjustment applies only to taxpayers making the election for the taxable year which includes the date of enactment. Any elections made thereafter will be governed by rules and procedures established by the Secretary of the Treasury.

[¶ 11,125] Act Sec. 1002. Law at ¶ 5117. CCH Explanation at ¶ 509.

Revenue-Increase Provisions—Financial Products

Senate Committee Report

[*Investment company exception*]

Limitation on exception for investment companies under section 351.—The bill modifies the definition of an investment company for purposes of determining whether a transfer of property to a partnership or corporation results in gain recognition (secs. 351(e) and 721(b)) by requiring that certain assets be taken into account for purposes of the definition, in addition to readily marketable stock and securities as under present law.

Under the bill, an investment company includes a RIC or REIT as under present law. In addition, under the bill, an investment company includes any corporation or partnership if more than 80 percent of its assets by value consist of money, stocks and other equity interests in a corporation, evidences of indebtedness, options, forward or futures contracts, notional principal contracts or derivatives, foreign currency, certain interests in precious metals, interests in REITs, RICs, common trust funds and publicly-traded partnerships or other interests in non-corporate entities that are convertible into or exchangeable for any of the assets listed. Other assets that count toward the 80-percent test are an interest in an entity substantially all of the assets of which are assets listed, and to the extent provided in Treasury regulations, interests in other entities, but only to the extent of the value of the interest that is attributable to assets listed.[69] Finally, the bill grants regulatory authority to the Treasury to add other assets to the list set out in the provision, or, under certain circumstances, to remove items from the list.

The bill is intended to change only the types of assets considered in the definition of an investment company in the present Treasury regulations (Treas. reg. sec. 1.351-1(c)(1)(ii)) and not to override the other provisions of those regulations. For example, the bill does not override (1) the requirement that only assets held for investment are considered for purposes of the definition (Treas. reg. sec. 1.351-1(c)(3)), (2) the rule treating the assets of a subsidiary as owned proportionally by a parent owning 50 percent or more of its stock (Treas. reg. sec. 1.351-1(c)(4)), (3) the requirement that the investment company determination consider any plan with regard to an entity's assets in existence at the time of transfer (Treas. reg. sec. 1.351-1(c)(2)[70]), and (4) the requirement that a contribution of property to an investment company result in diversification in order for gain to be recognized (Treas. reg. sec. 1.351-1(c)(1)(i)).

Effective date.—The provision applies to all transfers after June 8, 1997, in taxable years

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[69] Until such regulations are issued, it is intended that the Treasury regulations promulgated under the similar provisions of section 731(c)(2) generally will apply. Specifically, it is intended that an entity will meet the "substantially all" requirement if 90 percent or more of its assets are listed assets (Treas. reg. sec. 1.731-2(c)(3)(i)). Similarly, with respect to partnerships and other non-corporate entities, it is intended that, where 20 percent or more (but less than 90 percent) of the entity's assets consist of listed assets, a *pro rata* portion of the interest in the entity will be treated as a listed asset.(Treas. reg. sec. 1.731-2(c)(3)(ii))

[70] Although money is counted toward the 80-percent test under the bill, this provision in the regulations should have the effect that where money is contributed and, pursuant to a plan, assets not treated as stock or securities under the bill are either purchased or contributed by other parties, the investment company determination would be made only on the basis of the entity's assets after such events.

ending after such date. An exception is provided for transfers of a fixed amount of securities made pursuant to a binding written contract in effect on June 8, 1997, and at all times thereafter until the transfer.

Conference Committee Report

The conference agreement is the same as the Senate amendment.

[¶ 11,130] Act Sec. 1003. Law at ¶ 5345 and 5347. CCH Explanation at ¶ 307.

Revenue-Increase Provisions—Financial Products

Senate Committee Report

[*Gains and losses from terminations*]

Gains and losses from certain terminations with respect to property.—

Extension of relinquishment rule to all types of property.—The bill extends to all types of property the rule which treats gain or loss from the cancellation, lapse, expiration, or other termination of a right or obligation with respect to property which is (or on acquisition would be) a capital asset in the hands of the taxpayer.

By definition, the extension of the "sale or exchange rule" of present law section 1234A to all property will only affect property that is not personal property which is actively traded on an established exchange. Thus, the committee bill will apply to (1) interests in real property and (2) non-actively traded personal property. An example of the first type of property interest that will be affected by the committee bill is the tax treatment of amounts received to release a lessee from a requirement that the premise be restored on termination of the lease.[80] An example of the second type of property interest that is affected by the committee bill is the forfeiture of a down payment under a contract to purchase stock.[81] The committee bill does not affect whether a right is "property" or whether property is a "capital asset."

Character of gain or loss on retirement of debt obligations issued by natural persons.—The committee bill repeals the provision that exempts debt obligations issued by natural persons effective for obligations issued after June 8, 1997. In addition, the committee bill terminates the grandfather of debt issued before July 2, 1982, by noncorporations or nongovernments and by natural persons before June 9, 1997, from the rule which treats gain or loss realized on retirement of such debt as gain or loss realized on an exchange effective for obligations acquired after June 8, 1997, unless the acquirer's basis in the obligation is a carryover basis (i.e., the basis is determined soley by reference to the basis from whom the acquirer acquired the obligation). Thus, under the bill, gain or loss on the retirement of such debt will be capital gain or loss.

Effective date.—

Extension of relinquishment rule to all types of property.—The extension of the extinguishment rule applies to terminations occurring more than 30 days after the date of enactment of the provision.

Character of gain or loss on retirement of debt obligations issued by natural persons, etc.—The provision is effective for dispositions after the date of enactment. Thus, any gain or loss occurring after the date of enactment on (1) an obligation of a natural person issued after June 8, 1997, or (2) an obligation issued by a natural person on or before that date to which section 1271(b) currently applies and which is acquired after that date other than in a carryover basis transaction will be treated as a gain or loss from the exchange of the obligation.

Conference Committee Report

The conference agreement generally follows the Senate amendment.

In addition, the conference agreement provides that if a taxpayer enters into a short sale of property and such property becomes substantially worthless, the taxpayer shall recognize gain as if the short sale were closed when the property becomes substantially worthless. The conference agreement also extends the statute of limitations with respect to such gain recognition to the earlier of: (1) three years after the Treasury Secretary is notified that the position has become substantially worthless; or (2) six years after the date of filing of the income tax return for the taxable year during which the position became substantially worthless. To the extent provided in Treasury regulations, similar gain recognition rules shall apply to any option with respect to property, any

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[80] See *Billy Rose Diamond Horseshoe, Inc. v. Commissioner*, 448 F. 2d 549 (1971), where the Second Circuit held that payments were not entitled to capital gain treatment because there was no sale or exchange. See also, *Sirbo Holdings, Inc. v. Commissioner*, 509 F.2d 1220 (2d Cir. 1975).

[81] See *U.S. Freight Co. v. U.S.* 422 F.2d 887 (Ct. Cl. 1970), holding that forfeiture was an ordinary loss.

offsetting notional principal contract with respect to property, any futures or forward contract to deliver property, or with respect to any similar transaction or position that becomes substantially worthless. The provision applies to property that becomes substantially worthless after the date of enactment of the Act. No inference is intended as to the proper treatment of these or similar transactions or positions under present law.

[¶ 11,135] Act Sec. 1004. Law at ¶ 5359. CCH Explanation at ¶ 345.

Revenue-Increase Provisions—Financial Products

House Committee Report

[*Pooled debt obligations subject to acceleration*]

Determination of original issue discount where pooled debt obligations subject to acceleration.—The bill applies the special OID rule applicable to any regular interest in a REMIC, qualified mortgages held by a REMIC, or certain other debt instruments to any pool of debt instruments the payments on which may be accelerated by reason of prepayments. Thus, under the bill, if a taxpayer holds a pool of credit card receivables that require interest to be paid if the borrowers do not pay their accounts by a specified date, the taxpayer would be required to accrue interest or OID on such pool based upon a reasonable assumption regarding the timing of the payments of the accounts in the pool. In cases where the payments in the pool occur soon after year end and before the taxpayer files its tax return for such year end, the taxpayer may accrue interest based on its actual experience rather than based upon reasonable assumptions.

The bill operates as follows. Assume that a calendar year taxpayer issues credit cards, the terms of which provide that if charges for a calendar month are paid within 30 days after the close of the month, no interest will accrue with respect to such charges. However, if the balances are not paid within this 30-day grace period, interest will accrue from the date of the charge until the balance is paid. Further assume that the taxpayer issues a significant number of such credit cards and the card holders incur charges of $10 million in December 1997. Under present law (depending upon the taxpayer's accounting method), the taxpayer is not required to include any interest income in 1997 with respect to the December charges because it is possible that all the credit card holders will pay off the $10 million cumulative December balance by January 30, 1998, and therefore will not be subject to interest with respect to such charges. If some of the credit card holders do not pay their December charges by January 30, 1998, the balances of those holders will be subject to interest charges under the terms of the credit cards and the taxpayer would accrue such interest in income in 1998. Under the bill, the taxpayer, in computing its 1997 taxable income, would be required to make a reasonable assumption as to what portion of the $10 million balances will not be paid off within the 30-day grace period and would be required to accrue interest income through December 31, 1997, with respect to such portion. The taxpayer would then adjust such accrual in 1998 to reflect the extent to which such prepayment assumption reflected the actual payments received in January.

In addition, the Secretary of the Treasury is authorized to provide appropriate exemptions from the provision, including exemptions for taxpayers that hold a limited amount of debt instruments, such as small retailers.

Effective date.—The provision is effective for taxable years beginning after the date of enactment. If a taxpayer is required to change its method of accounting under the bill, such change would be treated as initiated by the taxpayer with the consent of the Secretary of the Treasury and any section 481 adjustment would be included in income ratably over a four-year period. It is understood that some taxpayers presently use a method of accounting similar to the method required to be used under the bill and have asked the Secretary of the Treasury for permission to change to a different method for pre-effective date years. So as not to require taxpayers to change methods of accounting multiple times, it is expected that the Secretary would not grant these pending requests.

Conference Committee Report

The conference agreement generally follows the House bill, with modifications. The conference agreement applies to any pool of debt instruments the yield on which may be affected by reason of prepayments. In addition, the conferees wish to clarify that it is within the discretion of the Secretary of the Treasury to grant changes of methods of accounting that are pending for pre-effective date years.

[¶ 11,140] Act Sec. 1005. Law at ¶ 5069. CCH Explanation at ¶ 513.

Revenue-Increase Provisions—Financial Products

House Committee Report

[*Interest deduction: Debt instruments*]

Deny interest deduction on certain debt instruments.—Under the bill, no deduction is allowed for interest or OID on an instrument issued by a corporation (or issued by a partnership to the extent of its corporate partners) that is payable in stock of the issuer or a related party (within the meaning of sections 267(b) and 707(b)), including an instrument a substantial portion of which is mandatorily convertible or convertible at the issuer's option into stock of the issuer or a related party. In addition, an instrument is be treated as payable in stock if a substantial portion of the principal or interest is required to be determined, or may be determined at the option of the issuer or related party, by reference to the value of stock of the issuer or related party. An instrument also is treated as payable in stock if it is part of an arrangement designed to result in such payment of the instrument with or by reference to such stock, such as in the case of certain issuances of a forward contract in connection with the issuance of debt, nonrecourse debt that is secured principally by such stock, or certain debt instruments that are convertible at the holder's option when it is substantially certain that the right will be exercised. For example, it is not expected that the provision will affect debt with a conversion feature where the conversion price is significantly higher than the market price of the stock on the issue date of the debt. The bill does not affect the treatment of a holder of an instrument.

The bill is not intended to affect the characterization of instruments as debt or equity under present law; and no inference is intended as to the treatment of any instrument under present law.

Effective date.—The provision is effective for instruments issued after June 8, 1997, but will not apply to such instruments (1) issued pursuant to a written agreement which was binding on such date and at all times thereafter, (2) described in a ruling request submitted to the Internal Revenue Service on or before such date, or (3) described in a public announcement or filing with the Securities and Exchange Commission on or before such date.

Conference Committee Report

The conference agreement follows the House bill. The conference agreement clarifies that for purposes of the provision, principal or interest shall be treated as required to be paid in, converted to, or determined with reference to the value of equity if it may be so required at the option of the holder or a related party and there is a substantial certainty that the option will be exercised.

[¶ 11,165] Act Sec. 1011. Law at ¶ 5337. CCH Explanation at ¶ 501.

Revenue-Increase Provisions —Corporate Organizations and Reorganizations

House Committee Report

[*Extraordinary dividends*]

Require gain recognition for certain extraordinary dividends.—Under the bill, except as provided in regulations, a corporate shareholder recognizes gain immediately with respect to any redemption treated as a dividend (in whole or in part) when the nontaxed portion of the dividend exceeds the basis of the shares surrendered, if the redemption is treated as a dividend due to options being counted as stock ownership.[90]

In addition, the bill requires immediate gain recognition whenever the basis of stock with respect to which any extraordinary dividend was received is reduced below zero. The reduction in basis of stock would be treated as occurring at the beginning of the ex-dividend date of the extraordinary dividend to which the reduction relates.

Reorganizations or other exchanges involving amounts that are treated as dividends under section 356 of the Code are treated as redemptions for purposes of applying the rules relating to redemptions under section 1059(e). For example, if a recapitalization or other transaction that involves a dividend under section 356 has the effect of a non pro rata redemption or is treated as a dividend due to options being counted as stock, the rules of section 1059 apply. Redemptions of shares, or other extraordinary dividends on shares, held by a partnership will be subject to section 1059 to the extent there are corporate partners (e.g., appropriate adjustments to the basis of the shares held by the partnership and to the basis of

[90] Thus, for example, where a portion of such a distribution would not have been treated as a dividend due to insufficient earnings and profits, the rule applies to the portion treated as a dividend.

the corporate partner's partnership interest will be required).

Under continuing section 1059(g) of present law, the Treasury Department is authorized to issue regulations where necessary to carry out the purposes and prevent the avoidance of the provision.

Effective date.—The provision generally is effective for distributions after May 3, 1995, unless made pursuant to the terms of a written binding contract in effect on May 3, 1995 and at all times thereafter before such distribution, or a tender offer outstanding on May 3, 1995.[91] However, in applying the new gain recognition rules to any distribution that is not a partial liquidation, a non pro rata redemption, or a redemption that is treated as a dividend by reason of options, September 13, 1995 is substituted for May 3, 1995 in applying the transition rules.

No inference is intended regarding the tax treatment under present law of any transaction within the scope of the provision, including transactions utilizing options.

In addition, no inference is intended regarding the rules under present law (or in any case where the treatment is not specified in the provision) for determining the shares of stock with respect to which a dividend is received or that experience a basis reduction.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,170] Act Sec. 1012. Law at ¶ 5117, 5121, 5125 and 5129. CCH Explanation at ¶ 503.

Revenue-Increase Provisions—Corporate Organizations/Reorganizations

Senate Committee Report

[*Controlled corporate stock distributions*]

Require gain recognition on certain distributions of controlled corporation stock.—The bill adopts additional restrictions under section 355 on acquisitions and dispositions of the stock of the distributing or controlled corporation.

Under the bill, if either the controlled or distributing corporation is acquired pursuant to a plan or arrangement in existence on the date of distribution, gain is recognized by the other corporation as of the date of the distribution.

In the case of an acquisition of a controlled corporation, the amount of gain recognized by the distributing corporation is the amount of gain that the distributing corporation would have recognized had stock of the controlled corporation been sold for fair market value on the date of distribution. In the case of an acquisition of the distributing corporation, the amount of gain recognized by the controlled corporation is the amount of net gain that the distributing corporation would have recognized had it sold its assets for fair market value immediately after the distribution. This gain is treated as long-term capital gain. No adjustment to the basis of the stock or assets of either corporation is allowed by reason of the recognition of the gain.

Whether a corporation is acquired is determined under rules similar to those of present law section 355(d), except that acquisitions would not be restricted to "purchase" transactions. Thus, an acquisition occurs if one or more persons acquire 50 percent or more of the vote or value of the stock of the controlled or distributing corporation pursuant to a plan or arrangement. For example, assume a corporation ("P") distributes the stock of its wholly owned subsidiary ("S") to its shareholders. If, pursuant to a plan or arrangement, 50 percent or more of the vote or value of either P or S is acquired by one or more persons, the bill proposal requires gain recognition by the corporation not acquired. Except as provided in Treasury regulations, if the assets of the distributing or controlled corporation are acquired by a successor in a merger or other transaction under section 368(a)(1)(A), (C) or (D) of the Code, the shareholders (immediately before the acquisition) of the corporation acquiring such assets are treated as acquiring stock in the corporation from which the assets were acquired. Under Treasury regulations, other asset transfers also could be subject to this rule. However, in any transaction, stock received directly or indirectly by former shareholders of distributing or controlled, in a successor or new controlling corporation of either, is not treated as acquired stock if it is attributable to such shareholders' stock in distributing or controlled that was not acquired as part of a plan or

[91] Thus, for example, in the case of a distribution prior to the effective date, the provisions of present law would continue to apply, including the provisions of present-law sections 1059(a) and 1059(d)(1), requiring reduction in basis immediately before any sale or disposition of the stock, and requiring recognition of gain at the time of such sale or disposition.

arrangement to acquire 50 percent or more of such successor or other corporation.

Acquisitions occurring within the four-year period beginning two years before the date of distribution are presumed to have occurred pursuant to a plan or arrangement. Taxpayers can avoid gain recognition by showing that an acquisition occurring during this four-year period was unrelated to the distribution.

The bill does not apply to distributions that would otherwise be subject to section 355(d) of present law, which imposes corporate level tax on certain disqualified distributions.

The bill does not apply to a distribution pursuant to a title 11 or similar case.

The Treasury Department is authorized to prescribe regulations as necessary to carry out the purposes of the proposal, including regulations to provide for the application of the proposal in the case of multiple transactions.

Except as provided in Treasury regulations, in the case of distributions of stock within an affiliated group of corporations (as defined in section 1504(a)), section 355 does not apply to any distribution of the stock of one member of the group to another member if it is part of a transaction that results in an acquisition that would be taxable to either the distributing or the controlled corporation.

In addition, in the case of any distribution of stock of one member of an affiliated group of corporations to another member, the Secretary of the Treasury is authorized under section 358(c) to provide adjustments to the basis of any stock in a corporation which is a member of such group, to reflect appropriately the proper treatment of such distribution.

As one example, the Secretary of the Treasury may consider providing rules that require a carryover basis within the group for the stock of the distributed corporation (including a carryover of an excess loss account, if any, in a consolidated return) and that also provide a reduction in the basis of the stock of the distributing corporation to reflect the change in the value and basis of the distributing corporation's assets. The Treasury Department may determine that the aggregate stock basis of distributing and controlled after the distribution may be adjusted to an amount that is less than the aggregate basis of the stock of the distributing corporation before the distribution, to prevent inappropriate potential for artificial losses or diminishment of gain on disposition of any of the corporations involved in the spin off.

The bill also modifies certain rules for determining control immediately after a distribution in the case of certain divisive transactions in which a controlled corporation is distributed and the transaction meets the requirements of section 355. In such cases, under section 351 and modified section 368(a)(2)(H) with respect to certain reorganizations under section 368(a)(1)(D), those shareholders receiving stock in the distributed corporation are treated as in control of the distributed corporation immediately after the distribution if they hold stock representing a greater than 50 percent interest in the vote and value of stock of the distributed corporation.

The bill does not change the present-law requirement under section 355 that the distributing corporation must distribute 80 percent of the voting power and 80 percent of each other class of stock of the controlled corporation. It is expected that this requirement will be applied by the Internal Revenue Service taking account of the provisions of the bill regarding plans that permit certain types of planned restructuring of the distributing corporation following the distribution, and to treat similar restructurings of the controlled corporation in a similar manner. Thus, the 80-percent control requirement is expected to be administered in a manner that would prevent the tax-free spin-off of a less-than-80-percent controlled subsidiary, but generally would not impose additional restrictions on post-distribution restructurings of the controlled corporation if such restrictions would not apply to the distributing corporation.

Effective date.—The bill is generally effective for distributions after April 16, 1997. However, the part of the bill providing a greater-than-50-percent control requirement immediately after certain section 351 and 368(a)(1)(D) distributions will be effective for transfers after the date of enactment.

The bill will not apply to a distribution after April 16, 1997 that is part of an acquisition that would otherwise cause gain recognition to the distributing or controlled corporation under the bill, if such acquisition is (1) made pursuant to a written agreement which was binding on April 16, 1997 and at all times thereafter; (2) described in a ruling request submitted to the Internal Revenue Service on or before such date; or (3) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission ("SEC") required solely by reason of the distribution or acquisition. Any written agreement, ruling request, or public announcement or SEC filing is not within the scope of these transition provisions unless it identifies the acquiror of the distributing corporation or of any controlled corporation, whichever is applicable.

The part of the bill providing a greater-than-50-percent control provision for certain transfers after the date of enactment will not apply if such transfer meets the requirements of (1), (2), or (3) of the preceding paragraph.

Conference Committee Report

The conference agreement follows the Senate amendment with additional modifications.

Amount and timing of gain recognition under section 355(e).—Under the conference agreement, in the case of an acquisition of either the distributing corporation or the controlled corporation, the amount of gain recognized is the amount that the distributing corporation would have recognized had the stock of the controlled corporation been sold for fair market value on the date of the distribution. Such gain is recognized immediately before the distribution. As under the House bill and Senate amendment, no adjustment to the basis of the stock or assets of either corporation is allowed by reason of the recognition of the gain.[13]

Acquisitions resulting in gain recognition.—Under the conference agreement, as under the House bill and Senate amendment, the gain recognition provisions of section 355(e) apply when one or more persons acquire 50 percent or more of the voting power or value of the stock of either the distributing corporation or the controlled corporation, pursuant to a plan or series of related transactions.

The conference agreement provides certain additions and clarifications to identify cases that do not cause gain recognition under the provisions of section 355(e).

Single affiliated group.—Under the conference agreement, a plan (or series of related transactions) is not one that will cause gain recognition if, immediately after the completion of such plan or transactions, the distributing corporation and all controlled corporations are members of a single affiliated group of corporations (as defined in section 1504 without regard to subsection (b) thereof).

Example 1: P corporation is a member of an affiliated group of corporations that includes subsidiary corporation S and subsidiary corporation S1. P owns all the stock of S. S owns all the stock of S1. P corporation is merged into unrelated X corporation in a transaction in which the former shareholders of X corporation will own 50 percent or more of the vote or value of the stock of surviving X corporation after the merger. As part of the plan of merger, S1 will be distributed by S to X, in a transaction that otherwise qualifies under section 355. After this distribution, S, S1, and X will remain members of a single affiliated group of corporations under section 1504 (without regard to whether any of the corporations is a foreign corporation, an insurance company, a tax exempt organization, or an electing section 936 company). Even though there has been an acquisition of P, S, and S1 by X, and a distribution of S1 by S that is part of a plan or series of related transactions, the plan is not treated as one that requires gain recognition on the distribution of S1 to X. This is because the distributing corporation S and the controlled corporation S1 remain within a single affiliated group after the distribution (even though the P group has changed ownership).

Continuing direct or indirect ownership.—The conference agreement clarifies that an acquisition does not require gain recognition if the same persons own 50 percent or more of both corporations, directly or indirectly (rather than merely indirectly, as in the House bill and Senate amendment), before and after the acquisition and distribution, provided the stock owned before the acquisition was not acquired as part of a plan (or series of related transactions) to acquire a 50-percent or greater interest in either distributing or controlled.

Example 2: Individual A owns all the stock of P corporation. P owns all the stock of a subsidiary corporation, S. Subsidiary S is distributed to individual A in a transaction that otherwise qualifies under section 355. As part of a plan, P then merges with corporation X, also owned entirely by individual A. There is not an acquisition that requires gain recognition under the provision, because individual A owns directly or indirectly 100 percent of all the stock of both X, the successor to P, and S before and after the transaction.[14] The same result would occur if P were contributed to a holding company, all the stock of which is owned by A.

The conference agreement, following the House bill and Senate amendment, continues to provide that except as provided in Treasury regulations, certain other acquisitions are not taken into account. For example, under section 355(e)(3)(A), the following other types of acquisitions of stock are not subject to the provision, provided that the stock owned before the acquisition was not acquired pursuant to a plan or series of related transactions to acquire a 50-percent or greater ownership interest in either distributing or controlled:

First, the acquisition of stock in the controlled corporation by the distributing corporation (as one example, in the case of a drop-down of property by the distributing corporation to the corporation to be distributed in exchange for the stock of the controlled corporation);

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[13] There is no intention to limit the otherwise applicable Treasury regulatory authority under section 336(e) of the Code. There is also no intention to limit the otherwise applicable provisions of section 1367 with respect to the effect on shareholder stock basis of gain recognized by an S corporation under this provision.

[14] The example assumes that A did not acquire his or her stock in P as part of a plan or series of related transactions that results in the direct or indirect ownership of 50 percent or more of S or P separately by A. If A's stock in P was acquired as part of such a plan, the transaction would be one requiring gain recognition on the spin-off of S.

Second, the acquisition by a person of stock in any controlled corporation by reason of holding stock or securities in the distributing corporation (as one example, the receipt by a distributing corporation shareholder of controlled corporation stock in a distribution—including a split-off distribution in which a shareholder that did not own 50 percent of the stock of distributing owns 50 percent or more of the stock of controlled); and

Third, the acquisition by a person of stock in any successor corporation of the distributing corporation or any controlled corporation by reason of holding stock or securities in such distributing or controlled corporation (for example, the receipt by former shareholders of distributing of 50 percent or more of the stock of a successor corporation in a merger of distributing).

As under the House bill and Senate amendment, a public offering of sufficient size can result in an acquisition that causes gain recognition under the provision.

Attribution.—The conference agreement also modifies the attribution rule for determining when an acquisition has occurred. Rather than apply section 355(d)(8)(A), which attributes stock owned by a corporation to a corporate shareholder only if that shareholder owns 10 percent of the corporation, the conference agreement provides that, except as provided in regulations, section 318(a)(2)(C) applies without regard to the amount of stock ownership of the corporation.

Example 3: Assume the facts are the same as in the immediately preceding example except that corporations P and X are each owned by the same 20 individual 5-percent shareholders (rather than wholly by individual A). The transaction described in the previous example, in which S is spun off by P to P's shareholders and P is acquired by X, would not cause gain recognition, because the same shareholders would own directly or indirectly 50 percent or more of the stock of each corporation both before and after the transaction.

Section 355(f).—The conference agreement follows the Senate amendment in providing that, except as provided in Treasury regulations, section 355 (or so much of section 356 as relates to section 355) shall not apply to the distribution of stock from one member of an affiliated group of corporations (as defined in section 1504(a)) to another member of such group (an "intragroup spin-off") if such distribution is part of a plan (or series of related transactions) described in subsection (e)(2)(A)(ii), pursuant to which one or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation.

Example 4: P corporation owns all the stock of subsidiary corporation S. S owns all the stock of subsidiary corporation T. S distributes the stock of T corporation to P as part of a plan or series of related transactions in which P then distributes S to its shareholders and then P is merged into unrelated X corporation. After the merger, former shareholders of X corporation own 50 percent or more of the voting power or value of the stock of the merged corporation. Because the distribution of T by S is part of a plan or series of related transactions in which S is distributed by P outside the P affiliated group and P is then acquired under section 355(e), section 355 in its entirety does not apply to the intragroup spin-off of T to P, under section 355(f). Also, the distribution of S by P is subject to section 355(e).

The conference agreement clarifies that, in determining whether an acquisition described in subsection (e)(2)(A)(ii) occurs, all the provisions of new subsection 355(e) are applied. For example, an intragroup spin-off in connection with an overall transaction that does not cause gain recognition under section 355(e) because it is described in section 355(e)(2)(C), or because of section 355(e)(3), is not subject to the rule of section 355(f).The Treasury Department has regulatory authority to vary the result that the intragroup distribution under section 355(f) does not qualify for section 355 treatment. In this connection, the Treasury Department could by regulation eliminate some or all of the gain recognition required under section 355(f) in connection with the issuance of regulations that would cause appropriate basis results with respect to the stock of S and T in the above example so that concerns regarding present law section 355 basis rules (described below in connection with section 358(c)) would be eliminated.[15]

Treasury regulatory authority under section 358(c).—As under the Senate amendment, the conference agreement provides that in the case of any distribution of stock of one member of an affiliated group of corporations to another member under section 355 ("intragroup spin-off"), the Secretary of the Treasury is authorized under section 358(c) to provide adjustments to the basis of any stock in a corporation which is a member of such group, to reflect appropriately the proper treatment of such distribution. It is understood that the approach of any such regulations applied to intragroup spin-offs that do not involve an acquisition may also be applied under the Treasury regulatory authority to modify the rule of section 355(f) as may be appropriate.

[15] Examples of approaches that the Treasury Department may consider are discussed in connection with section 358(c), *infra*.)

The conferees believe that the concerns relating to basis adjustments in the case of intragroup spin offs are essentially similar, whether or not an acquisition is currently intended as part of a plan or series of related transactions. The concerns include the following. First, under present law consolidated return regulations, it is possible that an excess loss account of a lower tier subsidiary may be eliminated. This creates the potential for the subsidiary to leave the group without recapture of the excess loss account, even though the group has benefitted from the losses or distributions in excess of basis that led to the existence of the excess loss account.

Second, under present law, a shareholder's stock basis in its stock of the distributing corporation is allocated after a spin-off between the stock of the distributing and controlled corporations, in proportion to the relative fair market values of the stock of those companies. If a disproportionate amount of asset basis (as compared to value) is in one of the companies (including but not limited to a shift of value and basis through a borrowing by one company and contribution of the borrowed cash to the other), present law rules under section 358(c) can produce an increase in stock basis relative to asset basis in one corporation, and a corresponding decrease in stock basis relative to asset basis in the other company. Because the spin-off has occurred within the corporate group, the group can continue to benefit from high inside asset basis either for purposes of sale or depreciation, while also choosing to benefit from the disproportionately high stock basis in the other corporation. If, for example, both corporations were sold at a later date, a prior distribution can result in a significant decrease in the amount of gain recognized than would have occurred if the two corporations had been sold together without a prior spin off (or separately, without a prior spin-off).

Example 5: P owns all the stock of S1 and S1 owns all the stock of S2. P's basis in the stock of S1 is 50; the inside asset basis of S1's assets is 50; and the total value of S1's stock and assets (including the value of S2) is 150. S1's basis in the stock of S2 is 0; the inside basis of S2's assets is 0; and the value of S2's stock and assets is 100. If S1 were sold, holding S2, the total gain would be 100. S1 distributes S2 to P in a section 355 transaction. After this spin-off, under present law, P's basis in the stock of S1 is approximately 17 (50/150 times the total 50 stock basis in S1 prior to the spin-off) and the inside asset basis of S1 is 50. P's basis in the stock of S2 is 33 (100/150 times the total 50 stock basis in S1 prior to the spin-off) and the inside asset basis of S2 is 0. After a period of time, S2 can be sold for its value of 100, with a gain of 67 rather than 100. Also, since S1 remains in the corporate group, the full 50 inside asset basis can continue to be used. S1's assets could be sold for 50 with no gain or loss. Thus, S1 and S2 can be sold later at a total gain of 67, rather than the total gain of 100 that would have occurred had they been sold without the spin-off.

As one variation on the foregoing concern, taxpayers have attempted to utilize spin-offs to extract significant amounts of asset value and basis, (including but not limited to transactions in which one corporation decreases its value by incurring debt, and increases the asset basis and value of the other corporation by contributing the proceeds of the debt to the other corporation) without creation of an excess loss account or triggering of gain, even when the extraction is in excess of the basis in the distributing corporation's stock.

The Treasury Department may promulgate any regulations necessary to address these concerns and other collateral issues. As one example, the Treasury Department may consider providing rules that require a carryover basis within the group (or stock basis conforming to asset basis as appropriate) for the distributed corporation (including a carryover of an excess loss account, if any, in a consolidated return). Similarly, the Treasury Department may provide a reduction in the basis of the stock of the distributing corporation to reflect the change in the value and basis of the distributing corporation's assets. The Treasury Department may determine that the aggregate stock basis of distributing and controlled after the distribution may be adjusted to an amount that is less than the aggregate basis of the stock of the distributing corporation before the distribution, to prevent inappropriate potential for artificial losses or diminishment of gain on disposition of any of the corporations involved in the spin-off. The Treasury Department may provide separate regulations for corporations in affiliated groups filing a consolidated return and for affiliated groups not filing a consolidated return, as appropriate to each situation.

Effective date.—The conferees wish to clarify certain aspects of the effective date and transitional relief under the provision.

First, the conference agreement clarifies that an acquisition of stock that occurs on or before April 16, 1997 will not cause gain recognition under the provision, even if there is a distribution after that date that is part of a plan or series of related transactions that would otherwise be subject to the provision.

Second, any contract that is in fact binding under State law as of April 16, 1997, even though not written, is eligible for transition relief. It would be expected, in such a case, that some form of contemporaneous written evidence of such contract would be in existence. As one example, if under State law acceptance of the terms and conditions of a contract by a corporate board of

directors creates a binding contract with an acquiror, then such contract, and the terms and conditions presented to the board, could satisfy the requirement for binding contract transitional relief under the conference agreement. If there was such an offer and acceptance on or before April 16, 1997 and a ruling request filed on or before April 16, 1997, with respect to a proposed spin-off and acquisition, which identifies the acquiror as one of a list of prospective acquirors, then the transaction may be eligible for relief under the transition rules.

Finally, with respect to the Treasury Department regulatory authority under section 358(c) as applied to intragroup spin-off transactions that are not part of a plan or series of related transactions under new section 355(f), the conferees expect that any Treasury regulations will be applied prospectively, except in cases to prevent abuse.

[¶ 11,175] Act Sec. 1013. Law at ¶ 5111 and 5337. CCH Explanation at ¶ 505.

Revenue-Increase Provisions—Corporate Organizations and Reorganizations

House Committee Report

[*Corporate stock transfer reform*]

Reform tax treatment of certain corporate stock transfers.—Under the bill, to the extent that a section 304 transaction is treated as a distribution under section 301, the transferor and the acquiring corporation are treated as if (1) the transferor had transferred the stock involved in the transaction to the acquiring corporation in exchange for stock of the acquiring corporation in a transaction to which section 351(a) applies, and (2) the acquiring corporation had then redeemed the stock it is treated as having issued. Thus, the acquiring corporation is treated for all purposes as having redeemed the stock it is treated as having issued to the transferor. In addition, the bill amends section 1059 so that, if the section 304 transaction is treated as a dividend to which the dividends received deduction applies, the dividend is treated as an extraordinary dividend in which only the basis of the transferred shares would be taken into account under section 1059.

Under the bill, a special rule applies to section 304 transactions involving acquisitions by foreign corporations. The bill limits the earnings and profits of the acquiring foreign corporation that are taken into account in applying section 304. The earnings and profits of the acquiring foreign corporation to be taken into account will not exceed the portion of such earnings and profits that (1) is attributable to stock of such acquiring corporation held by a corporation or individual who is the transferor (or a person related thereto) and who is a U.S. shareholder (within the meaning of sec. 951(b)) of such corporation, and (2) was accumulated during periods in which such stock was owned by such person while such acquiring corporation was a controlled foreign corporation. For purposes of this rule, except as otherwise provided by the Secretary of the Treasury, the rules of section 1248(d) (relating to certain exclusions from earnings and profits) would apply. The Secretary of the Treasury is to prescribe regulations as appropriate, including regulations determining the earnings and profits that are attributable to particular stock of the acquiring corporation.

No inference is intended as to the treatment of any transaction under present law.

Effective date.—The provision is effective for distributions or acquisitions after June 8, 1997 except that the provision will not apply to any such distribution or acquisition (1) made pursuant to a written agreement which was binding on such date and at all times thereafter, (2) described in a ruling request submitted to the Internal Revenue Service on or before such date, or (3) described in a public announcement or filing with the Securities and Exchange Commission on or before such date.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House Bill and the Senate amendment.

[¶ 11,180] Act Sec. 1014. Law at ¶ 5117, 5119, 5121, 5123 and 5327. CCH Explanation at ¶ 507.

Revenue-Increase Provisions—Corporate

House Committee Report

[*Preferred stock as "boot"*]

Treat certain preferred stock as "boot."—The bill amends the relevant provisions (secs. 351, 354, 355, 356 and 1036) to treat certain preferred stock as "other property" (i.e., "boot") subject to certain exceptions. Thus, when a taxpayer exchanges property for this preferred stock in a transaction that qualifies under either section

351, 355, 368, or 1036, gain but not loss is recognized.

The bill applies to preferred stock (i.e., stock that is limited and preferred as to dividends and does not participate, including through a conversion privilege, in corporate growth to any significant extent), where (1) the holder has the right to require the issuer or a related person (within the meaning of secs. 267(b) and 707(b)) to redeem or purchase the stock, (2) the issuer or a related person is required to redeem or purchase the stock, (3) the issuer (or a related person) has the right to redeem or purchase the stock and, as of the issue date, it is more likely than not that such right will be exercised, or (4) the dividend rate on the stock varies in whole or in part (directly or indirectly) with reference to interest rates, commodity prices, or other similar indices, regardless of whether such varying rate is provided as an express term of the stock (for example, in the case of an adjustable rate stock) or as a practical result of other aspects of the stock (for example, in the case of auction rate stock). For this purpose, the rules of (1), (2), and (3) apply if the right or obligation may be exercised within 20 years of the date the instrument is issued and such right or obligation is not subject to a contingency which, as of the issue date, makes remote the likelihood of the redemption or purchase. In addition, if neither the stock surrendered nor the stock received in the exchange is stock of a corporation any class of stock of which (or of a related corporation) is publicly traded, a right or obligation is disregarded if it may be exercised only upon the death, disability, or mental incompetency of the holder. Also, a right or obligation is disregarded in the case of stock transferred in connection with the performance of services if it may be exercised only upon the holder's separation from service.

The following exchanges are excluded from this gain recognition: (1) certain exchanges of preferred stock for comparable preferred stock of the same or lesser value; (2) an exchange of preferred stock for common stock; (3) certain exchanges of debt securities for preferred stock of the same or lesser value; and (4) exchanges of stock in certain recapitalizations of family-owned corporations. For this purpose, a family-owned corporation is defined as any corporation if at least 50 percent of the total voting power and value of the stock of such corporation is owned by members of the same family for five years preceding the recapitalization. In addition, a recapitalization does not qualify for the exception if the same family does not own 50 percent of the total voting power and value of the stock throughout the three-year period following the recapitalization. Members of the same family are defined by reference to the definition in section 447(e). Thus, a family includes children, parents, brothers, sisters, and spouses, with a limited attribution for directly and indirectly owned stock of the corporation. Shares held by a family member are treated as not held by a family member to the extent a nonfamily member had a right, option or agreement to acquire the shares (directly or indirectly, for example, through redemptions by the issuer), or with respect to shares as to which a family member has reduced its risk of loss with respect to the share, for example, through an equity swap. Even though the provision excepts certain family recapitalizations, the special valuation rules of section 2701 for estate and gift tax consequences continue to apply.

An exchange of nonqualified preferred stock for nonqualified preferred stock in an acquiring corporation may qualify for tax-free treatment under section 354, but not section 351. In cases in which both sections 354 and 351 may apply to a transaction, section 354 generally will apply for purposes of this proposal. Thus, in that situation, the exchange would be tax free.

The Treasury Secretary has regulatory authority to (1) apply installment sale-type rules to preferred stock that is subject to this proposal in appropriate cases and (2) prescribe treatment of preferred stock subject to this provision under other provisions of the Code (e.g., secs. 304, 306, 318, and 368(c)). Until regulations are issued, preferred stock that is subject to the proposal shall continue to be treated as stock under other provisions of the Code.

Effective date.—The provision is effective for transactions after June 8, 1997, but will not apply to such transactions (1) made pursuant to a written agreement which was binding on such date and at all times thereafter, (2) described in a ruling request submitted to the Internal Revenue Service on or before such date, or (3) described in a public announcement or filing with the Securities and Exchange Commission on or before such date.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment with certain clarifications.

The conference agreement clarifies that nonqualified preferred stock is treated as "boot" under section 351(b). The transferor receiving such stock thus is not treated as receiving nonrecognition treatment under section 351(a). However, the nonqualified preferred stock continues to be treated as stock received by a transferor for purposes of qualification of a transaction under section 351(a), unless and until regulations may provide otherwise.

Thus, for example, if A contributes appreciated property to new corporation X for all the common stock (representing 90 percent of the value and all the voting power) of X stock and B contributes cash for nonqualified preferred stock representing 10 percent of the value of X stock, B has received "boot," but the preferred stock is still treated as stock for purposes of sections 351(a) and 368(c), unless and until Treasury Regulations are issued requiring a different result. Thus, the transaction qualifies for non-recognition under section 351. If B had received other stock in addition to nonqualified preferred stock, B would be required to recognize gain only to the extent of the fair market value of the nonqualified preferred stock B receives.

The conference agreement also clarifies the treatment of certain conversion or exchange rights, by deleting any statutory reference to the existence of a "conversion privilege." The conferees wish to clarify that in no event will a conversion privilege into stock of the issuer automatically be considered to constitute participation in corporate growth to any significant extent. The conferees also wish to clarify that stock that is convertible or exchangeable into stock of a corporation other than the issuer (including, for example, stock of a parent corporation or other related corporation) is not considered to be stock that participates in corporate growth to any significant extent for purposes of the provision.

[¶ 11,185] Act Sec. 1015. Law at ¶ 5093. CCH Explanation at ¶ 517.

Revenue-Increase Provisions—Corporate Organizations and Reorganizations

Senate Committee Report

[*Dividends-received deduction: Holding period*]

Modify holding period for dividends-received deduction.—The bill provides that a taxpayer is not entitled to a dividends-received deduction if the taxpayer's holding period for the dividend-paying stock is not satisfied over a period immediately before or immediately after the taxpayer becomes entitled to receive the dividend.

Effective date.—The provision is generally effective for dividends paid or accrued after the 30th day after the date of the enactment of the bill. However, the provision will not apply to dividends received within two years of the date of enactment if (1) the dividend is paid with respect to stock held on June 8, 1997, and all times thereafter until the dividend is received; (2) the stock is continuously subject to a position described in section 246(c)(4) on June 8, 1997, and all times thereafter until the dividend is received; and (3) such stock and related position is identified by the taxpayer within 30 days after enactment of this Act. A stock will not be considered to be continuously subject to a position if such position is sold, closed or otherwise terminated and is reestablished.

Conference Agreement.—The conference agreement follows the Senate amendment.

[¶ 11,215] Act Sec. 1021. Law at ¶ 5599. CCH Explanation at ¶ 1052.

Revenue-Increase Provisions—Administrative

House Committee Report

[*Reporting payments to attorneys*]

Reporting of certain payments made to attorneys.—The provision requires gross proceeds reporting on all payments to attorneys made by a trade or business in the course of that trade or business. It is anticipated that gross proceeds reporting would be required on Form 1099-B (currently used by brokers to report gross proceeds). The only exception to this new reporting requirement would be for any payments reported on either Form 1099-Misc under section 6041 (reports of payment of income) or on Form W-2 under section 6051 (payments of wages).

In addition, the present exception in the regulations exempting from reporting any payments made to corporations will not apply to payments made to attorneys. Treasury regulation section 1.6041-3(c) exempts payments to corporations generally (although payments to most corporations providing medical services must be reported). Reporting will be required under both Code sections 6041 and 6045 (as proposed) for payments to corporations that provide legal services. The exception of Treasury regulation section 1.6041-3(g) exempting from reporting payments of salaries or profits paid or distributed by a partnership to the individual partners would continue to apply to both sections (since these amounts are required to reported on Form K-1).

First, the provision applies to payments made to attorneys regardless of whether the attorney is the exclusive payee. Second, payments to law firms are payments to attorneys, and therefore are subject to this reporting provision. Third, attorneys are required to promptly supply their TINs to persons required to file these information reports, pursuant to section 6109. Failure to do so could result in the attorney being subject to penalty under section 6723 and the payments being

subject to backup withholding under section 3406. Fourth, the IRS should administer this provision so that there is no overlap between reporting under section 6041 and reporting under section 6045. For example, if two payments are simultaneously made to an attorney, one of which represents the attorney's fee and the second of which represents the settlement with the attorney's client, the first payment would be reported under section 6041 and the second payment would not be reported under either section 6041 or section 6045, since it is known that the entire payment represents the settlement with the client (and therefore no portion of it represents income to the attorney).

Effective date.—The provision is effective for payments made after December 31, 1997. Consequently, the first information reports will be filed with the IRS (and copies will be provided to recipients of the payments) in 1999, with respect to payments made in 1998.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 11,220] Act Sec. 1022. Law at ¶ 5597. CCH Explanation at ¶ 1055.

Revenue-Increase Provisions—Administrative

House Committee Report

[*Reporting Federal agency contract payments*]

Information reporting on persons receiving contract payments from certain Federal agencies.—The provision requires reporting of all payments of $600 or more made by a Federal executive agency to any person (including a corporation) for services. In addition, the provision requires that a copy of the information return be sent by the Federal agency to the recipient of the payment. An exception is provided for certain classified or confidential contracts.

Effective date.—The provision is effective for returns the due date for which (without regard to extensions) is more than 90 days after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,225] Act Sec. 1023. Law at ¶ 5613. CCH Explanation at ¶ 1043.

Revenue-Increase Provisions—Administrative

House Committee Report

[*Return disclosure: Veterans programs*]

Disclosure of tax return information for administration of certain veterans programs.—The provision permanently extends the [Department of Veterans Affairs (DVA)] disclosure provision.

Effective date.—The provision is effective on the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement extends the DVA disclosure provision through September 30, 2003.

[¶ 11,230] Act Sec. 1024. Law at ¶ 5663. CCH Explanation at ¶ 1019.

Revenue-Increase Provisions—Administrative

House Committee Report

[*IRS continuous levy*]

Establish IRS continuous levy and improve debt collection.—

Continuous levy.—The provision amends the Code to provide that a continuous levy is also applicable to non-means tested recurring Federal payments. This is defined as a Federal payment for which eligibility is not based on the income and/or assets of a payee. For example, Social Security payments, which are subject to levy

under present law, would become subject to continuous levy.

In addition, the provision provides that this levy would attach up to 15 percent of any specified payment due the taxpayer. This rule explicitly replaces the other specifically enumerated exemptions from levy in the Code. A continuous levy of up to 15 percent would also apply to unemployment benefits and means-tested public assistance.

* * *

Effective date.—The provision is effective for levies issued after the date of enactment.

* * *

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,235] Act Sec. 1025. Law at ¶ 5665. CCH Explanation at ¶ 1022.

Revenue-Increase Provisions—Administrative

House Committee Report

[*Improve debt collection*]

Establish IRS continuous levy and improve debt collection.—

* * *

Modifications of levy exemptions.—The provision provides that the following property is not exempt from levy if the Secretary of the Treasury (or his delegate) approves the levy of such property:

(1) workmen's compensation payments,

(2) annuity or pension payments under the Railroad Retirement Act and benefits under the Railroad Unemployment Insurance Act,

(3) unemployment benefits, and

(4) means-tested public assistance.

Effective date.—The provision applies to levies issued after the date of enactment.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 11,240] Act Sec. 1026. Law at ¶ 5613. CCH Explanation at ¶ 1046.

Revenue-Increase Provisions—Administrative

House Committee Report (Code and Related Non-Code Provisions)

[*Return confidentiality and disclosure*]

Establish IRS continuous levy and improve debt collection.—

* * *

The bill also permits the disclosure of otherwise confidential tax return information to the Treasury Department's Financial Management Service only for the purpose of, and to the extent necessary in, implementing these levy provisions.

Effective date.—The provision is effective for levies issued after the date of enactment.

* * *

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,245] Act Sec. 1027. Law at ¶ 5585 and 5605. CCH Explanation at ¶ 273.

Revenue-Increase Provisions—Administrative

House Committee Report

[*Returns of trust and estate beneficiaries*]

Consistency rule for beneficiaries of trusts and estates.—Under the bill, a beneficiary of an estate or trust is required to file its return in a manner that is consistent with the information received from the estate or trust, unless the beneficiary files with its return a notification of inconsistent treatment identifying the inconsistency.

Effective date.—The provision is effective for returns filed after date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,250] Act Sec. 1028. Law at ¶ 5615, 5697 and 5707. CCH Explanation at ¶ 1058.

Revenue-Increase Provisions—Corporate

House Committee Report

[*Confidential corporate tax shelters: Substantial understatement penalty*]

Registration of confidential corporate tax shelters and substantial understatement penalty.—

Tax shelter registration.—The provision requires a promoter of a corporate tax shelter to register the shelter with the Secretary. Registration is required not later than the next business day after the day when the tax shelter is first offered to potential users. If the promoter is not a U.S. person, or if a required registration is not otherwise made, then any U.S. participant is required to register the shelter. An exception to this special rule provides that registration would not be required if the U.S. participant notifies the promoter in writing not later than 90 days after discussions began that the U.S. participant will not participate in the shelter and the U.S. person does not in fact participate in the shelter.

A corporate tax shelter is any investment, plan, arrangement or transaction (1) a significant purpose of the structure of which is tax avoidance or evasion by a corporate participant, (2) that is offered to any potential participant under conditions of confidentiality, and (3) for which the tax shelter promoters may receive total fees in excess of $100,000.

A transaction is offered under conditions of confidentiality if: (1) an offeree (or any person acting on its behalf) has an understanding or agreement with or for the benefit of any promoter to restrict or limit its disclosure of the transaction or any significant tax features of the transaction; or (2) the promoter claims, knows or has reason to know (or the promoter causes another person to claim or otherwise knows or has reason to know that a party other than the potential offeree claims) that the transaction (or one or more aspects of its structure) is proprietary to the promoter or any party other than the offeree, or is otherwise protected from disclosure or use. The promoter includes specified related parties.

Registration will require the submission of information identifying and describing the tax shelter and the tax benefits of the tax shelter, as we may require.

Tax shelter promoters are required to maintain lists of those who have signed confidentiality agreements, or otherwise have been subjected to nondisclosure requirements, with respect to particular tax shelters. In addition, promoters must retain lists of those paying fees with respect to plans or arrangements that have previously been registered (even though the particular party may not have been subject to confidentiality restrictions).

All registrations will be treated as taxpayer information under the provisions of section 6103 and will therefore not be subject to any public disclosure.

The penalty for failing to timely register a corporate tax shelter is the greater of $10,000 or 50 percent of the fees payable to any promoter with respect to offerings prior to the date of late registration (i.e., this part of the penalty does not apply to fee payments with respect to offerings after late registration). A similar penalty is applicable to actual participants in any corporate tax shelter who were required to register the tax shelter but did not. With respect to participants, however, the 50-percent penalty is based only on fees paid by that participant. Intentional disregard of the requirement to register by either a promoter or a participant increases the 50-percent penalty to 75 percent of the applicable fees.

Substantial understatement penalty.—The provision makes two modifications to the substantial understatement penalty. The first modification affects the reduction in the amount of the understatement which is attributable to an item if there is a reasonable basis for the treatment of the item. The provision provides that in no event would a corporation have a reasonable basis for its tax treatment of an item attributable to a multi-party financing transaction if such treatment does not clearly reflect the income of the corporation. No inference is intended that such a multi-party financing transaction could not also be a tax shelter as defined under the modification described below or under present law.

The second modification affects the special tax shelter rules, which define a tax shelter as an entity the principal purpose of which is the avoidance or evasion of Federal income tax. The provision instead provides that a significant purpose (rather than the principal purpose) of the entity must be the avoidance or evasion of Federal income tax for the entity to be considered a tax

shelter. This modification conforms the definition of tax shelter for purposes of the substantial understatement penalty to the definition of tax shelter for purposes of these new confidential corporate tax shelter registration requirements.

Treasury report.—The provision also directs the Treasury Department, in consultation with the Department of Justice, to issue a report to the tax-writing committees on the following tax shelter issues: (1) a description of enforcement efforts under section 7408 of the Code (relating to actions to enjoin promoters of abusive tax shelters) with respect to corporate tax shelters and the lawyers, accountants, and others who provide opinions (whether or not directly addressed to the taxpayer) regarding aspects of corporate tax shelters; (2) an evaluation of whether the penalties regarding corporate tax shelters are generally sufficient; and (3) an evaluation of whether confidential tax shelter registration should be extended to transactions where the investor (or potential investor) is not a corporation. The report is due one year after the date of enactment.

Effective date.—The tax shelter registration provision applies to any tax shelter offered to potential participants after the date the Treasury Department issues guidance with respect to the filing requirements. The modifications to the substantial understatement penalty apply to items with respect to transactions entered into after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,275] Act Sec. 1031. Law at ¶ 5473, 5479, 5485, 5503, 5505, 5507 and 5753. CCH Explanation at ¶ 1201.

Revenue-Increase Provisions—Excise Tax

House Committee Report

[*Airport and Airway Trust Fund taxes*]

Extension and modification of Airport and Airway Trust Fund excise taxes.—

Extension of Airport and Airway Trust Fund taxes.—The Airport and Airway Trust Fund excise taxes, as modified below, are extended for 10 years, for the period October 1, 1997, through September 30, 2007. The taxes that are extended include the domestic and international air passenger excise taxes, the air cargo excise tax, and the noncommercial aviation fuels taxes. Gross receipts from these taxes will continue to be deposited in the Airport and Airway Trust Fund.

Modification of commercial air passenger transportation taxes.—

Modify tax rates.—The current 10-percent domestic air passenger excise tax is changed to a tax equal to the *total* of 7.5 percent of the gross amount paid by the passenger for the transportation *plus* a $2.00 fixed dollar amount per flight segment. The fixed dollar amount per flight segment will be increased each January 1 for a four-year period, as follows:

Calendar year	*Per flight segment charge*
1999	$2.25
2000	2.50
2001	2.75
2002	3.00

Beginning on January 1, 2003, and each January 1 thereafter, the fixed dollar amount per flight segment will be indexed annually for inflation occurring after 2001, measured by changes in the Consumer Price Index (the "CPI") rounded to the nearest 10 cents. Inflation adjustments will be effective for transportation provided beginning after December 31, 2002, and in each subsequent calendar year.

The term "flight segment" is defined as transportation involving a single take-off and a single landing.[107] The bill provides that there is no change in the number of flight segments for which a passenger is charged (increase or decrease) in the case of transportation routing changes initiated by the air carrier, provided there is no change in the fare charged. Generally, this rule applies to flight changes for travel between the same origin and destination as a result of, e.g., aircraft mechanical problems. The rule similarly covers itinerary changes such as a diversion to another intermediate or destination airport as a result of inclement weather conditions.

All transportation between points within the 48 contiguous States (and within Hawaii or Alaska), other than domestic segments associated with international transportation, is subject to tax at the 7.5 percent and $2.00 rates.

The current $6 international departure tax is increased to $15.50 per departure, and an

[107] For example, travel from New York to San Francisco, with an intermediate stop in Chicago, would consists of two flight segments (without regard to whether the passenger changed aircraft in Chicago).

identical $15.50 per passenger tax is imposed on arrivals in the United States from international locations. The international departure and arrival taxes are indexed for inflation occurring after 1997, measured by changes in the CPI rounded to the nearest 10 cents. Inflation adjustments will be effective for transportation provided beginning after December 31, 1998, and each subsequent calendar year.

As under present law, certain air transportation between the United States and points within the 225-mile zone of Canada or Mexico is taxed as domestic transportation subject to the 7.5 percent and $2.00 rates. The present-law rules classifying transportation between the 48 contiguous States and Alaska or Hawaii (or between those States) as part domestic and part international are retained, without change, other than a clarification that a single flight segment between the 48 contiguous States and Alaska or Hawaii (or between those States) is subject to only one $15.50 per passenger international tax despite the fact that the flight both departs into and arrives from international airspace.

Extension of tax to certain currently exempt passengers.—As described above, passengers arriving in the United States from other countries, who currently are the only group of travelers whose transportation is subject neither to an excise tax nor a user fee for U.S.-provided aviation services, are subject to tax on their arriving international flights.

Clarification further is provided that any amounts paid to air carriers (in cash or in kind) for the right to award or otherwise distribute free or reduced-rate air transportation are treated as amounts paid for taxable air transportation, subject to the 7.5 percent *ad valorem* tax rate. Examples of such taxable amounts include (1) payments for frequent flyer miles purchased by credit card companies, telephone companies, rental car companies, television networks, restaurants and hotels, and other businesses for distribution to their customers and others and (2) amounts received by airlines pursuant to joint venture credit card or other marketing arrangements. The Treasury Department is authorized specifically to disregard accounting allocations or other arrangements which have the effect of reducing artificially the base to which the 7.5-percent tax is applied. No inference is intended from this provision as to the proper treatment of these payments under present law.

* * *

Liability for tax.—The present-law provision imposing liability for the tax on passengers (with transportation providers being liable for collecting and remitting revenues to the Federal Government) are modified to impose secondary liability on air carriers. As with the current tax, the aggregate tax will continue to be required to be stated separately on passenger tickets.

Transfer of 4.3-cents-per-gallon fuels excise tax to Airport and Airway Trust Fund.—The 4.3-cents-per-gallon excise tax on aviation gasoline and jet fuel will be deposited in the Airport and Airway Trust Fund, rather than in the General Fund, beginning with fuels sold or removed after September 30, 1997.

Modify air passenger excise tax deposit rules.—The deposit rules with respect to the commercial air passenger excise taxes are modified to permit payment of these taxes that otherwise would have been required to be deposited during the period August 15, 1997 through September 30, 1997, to be deposited on October 10, 1997.

Effective date.—These provisions generally are effective on the date of enactment, for air transportation beginning after September 30, 1997.

Present law requires transportation providers to continue collecting the commercial aviation excise taxes (at the current rates) on transportation to be provided after September 30, 1997, if the transportation is purchased before October 1, 1997. The bill requires transportation providers to collect the taxes at the modified rates for transportation purchased after the date of enactment for travel beginning after September 30, 1997.

The extension of the general aviation fuels excise taxes is effective for fuels removed or sold after September 30, 1997.

The provision clarifying application of the commercial air passenger excise tax to certain amounts paid for the right to award air transportation is effective for amounts paid (or benefits transferred) after September 30, 1997, except payments (or transfers) between related parties occurring after June 11, 1997 and before October 1, 1997, are subject to tax if the payments relate to rights to transportation to be awarded or otherwise distributed after September 30, 1997.

The provisions transferring certain General Fund fuels tax revenues and modifying the commercial air passenger excise tax deposit rules are effective on the date of enactment.

Conference Committee Report

Senate Amendment.—

Extension.—Subject to the modifications described below, the Senate amendment extends the present-law Airport and Airway excise taxes for 10 years, the same period as in the House bill.

Commercial passenger tax modifications.— * * * The Senate amendment also includes a 7.5-percent rate for flight segments to or from airports that enplaned no more than 100,000 passengers in the second preceding calendar year and

that either (1) are at least 75 miles from a airport that had more than 100,000 passenger enplanements in that year, or (2) qualify for essential air service subsidies as of the date of the amendment's enactment. The Senate amendment specifies that payments for frequent-flyer-type awards or similar price reductions through credit card and other arrangements are subject to the 10-percent tax.

* * * Both international departures and arrivals are taxed at $8 per passenger. Unlike under the comparable House bill provision, the $8 per passenger rate is not indexed.

Travel between the 48 contiguous States and Alaska or Hawaii (or between those two States) is taxed the same as under present law.

The Senate amendment is the same as the House bill on liability for tax. The Senate amendment provides two special delays in deposits: (1) taxes otherwise due in the period August 15-September 30, 1997, are due October 10, 1997; and (2) taxes otherwise due in the period July 1-September 30, 2001, are due October 10, 2001.

* * *

Conference Agreement.—

Extension.—The conference agreement follows the House bill and the Senate amendment (i.e., extends the present-law Airport and Airway Trust Fund excise taxes for 10 years, subject to the modifications described below).

Commercial passenger tax modifications.—The conference agreement follows the House bill's domestic passenger tax structure with the following modifications to the rates:

October 1, 1997–September 30, 1998	9 percent of the fare, plus $1 per domestic flight segment
October 1, 1998–September 30, 1999	8 percent of the fare, plus $2 per domestic flight segment
September 30, 1999–December 31, 1999	7.5 percent of the fare, plus $2.25 per domestic flight segment

After December 31, 1999, the *ad valorem* rate will remain at 7.5 percent. The domestic flight segment component of the tax will increase to $2.50 (January 1, 2000-December 31, 2000), to $2.75 (January 1, 2001-December 31, 2001), and to $3 (January 1, 2002-December 31, 2002). Beginning on January 1, 2003, the $3 rate will be indexed to the CPI as under the House bill.[29]

The conference agreement follows the Senate amendment on the treatment of certain domestic flight segments to and from qualified rural airports, with a modification. Under the conference agreement, the tax rate on these flight segments will be 7.5 percent of fare, with no flight segment rate being imposed on eligible flight segments.

The conference agreement follows the House bill and the Senate amendment provisions extending the tax on international departures and expanding that tax to include international arrivals, with a modification setting the tax rate on both international departures and arrivals at $12 per passenger (indexed to the CPI beginning on January 1, 1999, as under the House bill). The conferees believe this increased tax level is consistent with the user tax principles of the Airport and Airway Trust Fund taxes which include the recovery from international passengers of a greater percentage of the costs those passengers impose on FAA-programs than are collected by the present-law international departure tax, so that purely domestic passengers and the General Fund will not be required to subsidize the costs imposed by international travelers to the extent occurring under present law.

The conference agreement does not include the provision of the Senate amendment extending tax to domestic flights that connect to or from international flights. Rather, those flights will continue to be tax-free when the flights constitute segments of uninterrupted international transportation (i.e., the scheduled interval at any intermediate stop does not exceed 12 hours). If an intermediate stop exceeds 12 hours, subsequent domestic segments are taxed as domestic transportation.

The conference agreement follows the Senate amendment provision retaining the $6 per passenger rate applicable to the international airspace component of flights between the 48 contiguous States and Alaska or Hawaii (or to flights between Alaska and Hawaii).[30] For example, a passenger traveling from Los Angeles to Honolulu in December 1997 would be taxed at 9 percent of the fare applicable to U.S. territorial miles plus $1 per flight segment plus $6. As with the general $12 international arrival and departure rate, this $6-per-passenger rate will be indexed to the CPI beginning on January 1, 1999.

The conference agreement follows the House bill and Senate amendment provisions clarifying that the air passenger excise tax applies to payments to air carriers (and related parties) for the

[29] Similar to a provision of the House bill, the conference agreement includes a rule of administrative convenience that there is no change in the number of segment taxes imposed if a passenger's route between two locations is changed (with a resulting change in the number of domestic segments) if there is no change in the fare charged (including no imposition of any additional administrative or other fee associated with the route change).

[30] In contrast, transportation between Alaska or Hawaii and foreign countries (including U.S. possessions) is taxed exclusively as international travel, subject to the $12 per passenger arrival and departure tax.

right to award air travel benefits. The tax rate is 7.5 percent. Examples of such taxable payments include (1) payments for frequent flyer miles (including other rights to air transportation) purchased by credit card companies, telephone companies, rental car companies, television networks, restaurants and hotels, air carriers and related parties, and other businesses, and (2) amounts received by air carriers (or related parties) pursuant to joint venture credit card or other marketing arrangements. The conference agreement includes an exception to this general rule in the case of payments for air transportation rights between corporations that are members of a 100 percent commonly owned controlled group (e.g., transportation purchased from an air carrier by a 100 percent commonly owned corporation operating a frequent flyer award program for the air carrier).

The conferees are aware that consumers accrue mileage awards from numerous sources, including actual air travel as well as programs giving rise to taxable payments under this provision of the conference agreement. Once awarded to consumers, these miles are commingled in the consumer's account such that any miles used for a specific purpose may not be traceable to the source which gave rise to them. The conference agreement authorizes the Treasury Department to develop regulations excluding from the tax base a portion of otherwise taxable payments, if any, with respect to awarded frequent flyer miles if the Treasury determines that a portion properly can be allocated (traced) to miles which are used by consumers for purposes other than air transportation. Miles that are unused should not be treated as used for purposes other than air transportation. As part of any rulemaking process it undertakes, the Treasury is authorized to review airline frequent flyer programs and other information from all available sources, including industry and third-party data, in determining whether mileage awards can be adequately traced to support tax-base allocations based on the ultimate use of the awards. The conferees intend that an adjustment to the tax base will be prescribed only if the Treasury finds a consistent pattern of non-air transportation usage by consumers at levels indicating that significant mileage awarded pursuant to payments taxable under this provision is being used for purposes other than air transportation. In making any such adjustment, the Treasury Department should treat mileage used for non-air transportation purposes as coming first from mileage awarded to consumers from actual air travel (and other sources not subject to tax under this provision).

The conference agreement follows the House bill and the Senate amendment provisions extending secondary liability for the passenger taxes to air carriers.

The conference agreement includes the provision of the House bill changing certain commercial air passenger excise tax deposit dates for taxes otherwise due after August 14, 1997, and before October 1, 1997, to October 10, 1997. Additionally, the conference agreement provides that deposits of commercial air passenger taxes that otherwise would be required after August 14, 1998, and before October 1, 1998, will be due on October 5, 1998. Deposits of the commercial air cargo and aviation fuels taxes that otherwise would be required to be made after July 31, 1998, and before October 1, 1998, will be due on October 5, 1998.

* * *

Transfer of General Fund fuels tax revenues.—The conference agreement includes the House bill provision transferring gross receipts from the 4.3-cents-per-gallon general fund tax on aviation fuels to the Airport and Airway Trust Fund.

Effective date.—The conference agreement follows the House bill.

Enrollment Proceedings—Congressional Record

This enrolling resolution would make two corrections in the tax bill which just passed the House of Representatives, and that is H.R. 2014. * * *

The second correction would revise section 1031 of H.R. 2014 to delay the effective date of certain advance ticket purchases for air transportation beginning after September 30, 1997. The correction is needed to allow the airlines enough time to reprogram their computers for the new ticket pricing system as contained in H.R. 2014.—House Ways and Means Committee Chairman Bill Archer.

[¶ 11,285] Act Sec. 1032. Law at ¶ 5473, 5479, 5481, 5483, 5489, 5491, 5667, 5673, 5709, 5713, 5753 and 5757. CCH Explanation at ¶ 1211.

Revenue-Increase Provisions—Excise Tax

House Committee Report

[*Diesel fuel excise tax rules: Kerosene*]

Extend diesel fuel excise tax rules to kerosene.—The diesel fuel-excise tax rules are extended to kerosene. Thus, kerosene is be taxed when it is removed from a registered terminal unless it is indelibly dyed and destined for a nontaxable use. However, aviation-grade kerosene that is removed from the terminal by a registered producer of aviation fuel is not subject to the dyeing requirement and would be taxed under the present law rules applicable to aviation fuel. Feedstock kerosene that a registered industrial user receives by pipeline or vessel also is exempt from the dyeing requirement. Other feedstock kerosene would be exempt from the dyeing requirement to the extent and under conditions (including satisfaction of registration and certification requirements) prescribed by Treasury Department regulation.

To accommodate State safety regulations that require the use of clear (K-1) kerosene in certain space heaters, a refund procedure would be provided under which registered ultimate vendors may claim refunds of the tax paid on kerosene sold for that use. In addition, the Internal Revenue Service is given discretion to refund to a registered ultimate vendor the tax paid on kerosene that is blended with heating oil for use during periods of extreme or unseasonable cold.

Effective date.—The provision is effective for kerosene removed from terminal facilities after June 30, 1998. Appropriate floor stocks taxes will be imposed on kerosene held beyond the point of taxation on July 1, 1998.

Conference Committee Report

The conference agreement follows the House bill with modifications. First, registration as a terminal facility eligible to handle non-tax-paid diesel fuel and kerosene is conditional on the facility offering its customers dyeing for nontaxable sales of diesel fuel and kerosene. Second, the minimum amount for vendor refunds of tax paid on kerosene is reduced from $200 to $100. Third, the Treasury Department is given regulatory authority to allow tax-free sales of kerosene to wholesale dealers that (a) satisfy such registration and other compliance measures as Treasury may prescribe and (b) sell kerosene exclusively to retailers eligible for refunds with respect to undyed kerosene sold by them for a nontaxable use.

[¶ 11,290] Act Sec. 1033. Law at ¶ 5479. CCH Explanation at ¶ 1251.

Revenue-Increase Provisions—Excise Tax

House Committee Report

[*Leaking Underground Storage Tank Trusts*]

Reinstate Leaking Underground Storage Tank Trust Fund excise tax.—The bill reinstates for a 5-year period the prior-law Leaking Underground Storage Tank Trust Fund excise tax.

Effective date.—The provision is effective on the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment reinstates the tax for 10 years, from October 1, 1997, through September 30, 2007.

Effective date.—Date of enactment.

Conference Agreement.—The conference agreement follows the House bill and Senate amendment with a modification to the reinstatement period. The modified period is October 1, 1997, through March 31, 2005.

[¶ 11,295] Act Sec. 1034. Law at ¶ 5501. CCH Explanation at ¶ 1253.

Revenue-Increase Provisions—Excise Tax

House Committee Report

[*Long-distance prepaid cards*]

Application of communications tax to long-distance prepaid telephone cards.—The bill provides that any amounts paid to communications service providers (in cash or in kind) for the right to award or otherwise distribute free or reduced-rate long-distance telephone service are treated as amounts paid for taxable communication services, subject to the 3-percent *ad valorem* tax rate. Examples of such taxable amounts include (1) prepaid telephone cards offered through service stations, convenience stores and other businesses to their customers and others and (2) amounts received by communication service providers pursuant to joint venture credit card or other marketing arrangements. The Treasury Department is authorized specifically to disregard accounting allocations or other arrangements which have the effect of reducing artificially the base to which the 3-percent tax is applied. No inference is intended from this provision as to the proper treatment of these payments under present law.

Effective date.—The provision is effective for amounts paid on or after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment with technical modifications. The conference agreement clarifies that any amounts paid to communications service providers (in cash or in kind) for the right to award or otherwise distribute free or reduced-rate telephone service (i.e., local or toll telephone service) are treated as amounts paid for taxable communication services, subject to the 3-percent *ad valorem* tax rate.

The conference agreement also clarifies that the base to which the communications tax applies in the case of prepaid telephone cards and similar arrangements is the retail value of the service provided by the use of the card or arrangement. The conferees understand that prepaid telephone cards are offered to the public in two forms. The first type of prepaid telephone card can be called a "dollar value card." In this case, the final customer purchases a card or account which allows him to utilize $X worth of telephone service provided by an underlying telecommunications carrier. In this case, following the House bill and the Senate amendment, the conference agreement provides that the 3-percent communications excise tax apply to the value X at the time the prepaid telephone card is sold by a telecommunications carrier to a person who is not a telecommunications carrier.

The second type of prepaid telephone card can be called a "unit card" or a "minute card." In this case the final customer purchases a card or account which allows him to use Y number of units or minutes of telephone service provided by an underlying telecommunications carrier. The conferees intend that the tax applicable to such cards be based on the retail value of the telephone service offered to a consumer and the conference agreement grants the Treasury Department regulatory authority to determine the appropriate retail value. Presently, the Federal Communications Commission generally requires telecommunications carriers to file a tariff listing the prices of their various service offerings including the price of units or minutes offered via prepaid telephone cards. In this case, following the House bill and the Senate amendment, the conference agreement provides that the 3-percent communications excise tax will apply to Y (the number of units or minutes) multiplied by the tariffed price of those units or minutes at the time the prepaid telephone card is sold by a telecommunications carrier to a person who is not a telecommunications carrier. The conferees recognize that such a tariffed value may not in all cases correspond to the over-the-counter price that a final customer may pay for the card. However, the conferees believe that looking to the tariffed price, at present, is the best way to achieve neutral treatment of "dollar cards" and "unit" or "minute cards." The conferees understand that not all prepaid telephone cards may have an underlying tariff that applies to that particular card. In such cases, the conferees intend that tariffs for comparable telephone service be applied if applicable. The conferees believe that tariffs should continue to be filed for service offered via prepaid telephone cards, but if, in the future, tariff filings are not generally filed the conference agreement authorizes the Treasury Department to determine the appropriate retail value of the units or minutes of service offered on such cards.

The conferees understand that sometimes a communications service provider may require certain customers to prepay for their service as assurance that payment is made by the customer for services to be provided. The conferees do not consider such arrangements to constitute payment for communications services for the purposes of this provision if the customer is entitled to a full refund, in cash, for the value of any unused service. The conferees consider such ar-

rangements to be deposits to assure payment of service to be provided in the future.

No inference is intended from this provision as to the proper treatment of payments received by communications service providers for prepaid telephone cards and amounts received by communication service providers pursuant to joint venture credit card or other marketing arrangements under present law.

Effective date.—The conference agreement modifies the effective date so that the provision is effective for cards sold on or after the first day of the month which commences more than 60 days after the date of enactment.

[¶ 11,315] Act Sec. 1035. Law at ¶ 5467. CCH Explanation at ¶ 1120.

Other Revenue-Increase Provisions

Senate Committee Report

[*Federal unemployment surtax*]

Extension of Federal unemployment surtax.—The bill extends the temporary surtax rate through December 31, 2007. The bill also increases the limit from 0.25 percent to 0.50 percent of covered wages on the Federal Unemployment Account (FUA) in the Unemployment Trust Fund.

Effective date.—The provision is effective for labor performed on or after January 1, 1999.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 11,335] Act Sec. 1041. Law at ¶ 5173. CCH Explanation at ¶ 613.

Revenue-Increase Provisions—Tax-Exempt Organizations

House Committee Report

[*Extend UBIT to second-tier subsidiaries*]

Extend UBIT rules to second-tier subsidiaries and amend control test.—The bill modifies the test for determining control for purposes of section 512(b)(13). Under the bill, "control" means (in the case of a stock corporation) ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, control means ownership of more than 50 percent of the profits, capital or beneficial interests.

In addition, the bill applies the constructive ownership rules of section 318 for purposes of section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

The bill also makes technical modifications to the method provided in section 512(b)(13) for determining how much of an interest, rent, annuity, or royalty payment made by a controlled entity to a tax-exempt organization is includible in the latter organization's UBTI. Such payments are subject to the unrelated business income tax to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity.

Effective date.—The modification of the control test to one based on vote or value, the application of the constructive ownership rules of section 318, and the technical modifications to the flow-through method apply to taxable years beginning after the date of enactment. The reduction of the ownership threshold for purposes of the control test from 80 percent to more than 50 percent applies to taxable years beginning after December 31, 1998.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, except that the effective date is modified to provide temporary transition relief for certain payments. The provision does not apply to payments made during the first two taxable years beginning on or after the date of enactment if such payments are made pursuant to a binding written contract in effect as of June 8, 1997, and at all times thereafter before such payment. In addition, the conference agreement does not include the delayed application of the reduction of the ownership threshold for purposes of the control test from 80 percent to more than 50 percent.

[¶ 11,340] Act Sec. 1042. Law at ¶ 7028. CCH Explanation at ¶ 607.

Revenue-Increase Provisions—Tax-Exempt Organizations

House Committee Report (Related Non-Code Provision)

[*Pension business of certain insurers*]

Repeal grandfather rule with respect to pension business of certain insurers.—The provision repeals the grandfather rules applicable to that portion of the business of the Teachers Insurance Annuity Association-College Retirement Equities Fund which is attributable to pension business and to that portion of the business of Mutual of America which is attributable to pension business. The Teachers Insurance Annuity Association and College Retirement Equities Fund and Mutual of America are to be treated for Federal tax purposes as life insurance companies.

A fresh start is provided with respect to changes in accounting methods resulting from the change from tax-exempt to taxable status. Thus, no adjustment is made under section 481 on account of an accounting method change. The Teachers Insurance Annuity Association and College Retirement Equities Fund and Mutual of America are required to compute ending 1997 loss reserves without artificial changes that would reduce 1998 income. Thus, any reserve weakening after June 8, 1997, is treated as occurring in the organization's first taxable year beginning after December 31, 1997. The basis of assets of Teachers Insurance Annuity Association and College Retirement Equities Fund and Mutual of America is deemed to be equal to the amount of the assets' fair market value on the first day of the organization's taxable year beginning after December 31, 1997, for purposes of determining gain or loss (but not for determining depreciation or for other purposes).

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 11,365] Act Sec. 1051. Law at ¶ 5299. CCH Explanation at ¶ 936.

Other Foreign Provisions

House Committee Report

[*Foreign personal holding company income*]

Inclusion of income from notional principal contracts and stock lending transactions.—The bill treats net income from all types of notional principal contracts as a new category of foreign personal holding company income. However, income, gain, deduction or loss from a notional principal contract entered into to hedge an item of income in another category of foreign personal holding company income is included in that other category.

The bill treats payments in lieu of dividends derived from equity securities lending transactions pursuant to section 1058 as another new category of foreign personal holding company income.

The bill provides an exception from foreign personal holding company income for certain income, gain, deduction, or loss from transactions (including hedging transactions) entered into in the ordinary course of a CFC's business as a regular dealer in property, forward contracts, options, notional principal contracts, or similar financial instruments (including instruments referenced to commodities).

These modifications to the definition of foreign personal holding company income apply for purposes of determining a foreign corporation's status as a PFIC.

Effective date.—The provision applies to taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. The conferees wish to clarify the treatment of notional principal contracts under the provision. Although net income from notional principal contracts is added as a new category of foreign personal holding company income, amounts with respect to a notional principal contract entered into to hedge an item described in another category of foreign personal holding company income are taken into account under the rules of such other category. In this regard, gains and losses from transactions in inventory property are covered by an exclusion from the category of personal holding company income for net gains from property transactions; income from a notional principal contract entered into to hedge

inventory property is taken into account under such category and thus similarly is excluded from foreign personal holding company income.

[¶ 11,370] Act Sec. 1052. Law at ¶ 5319. CCH Explanation at ¶ 336.

Other Foreign Provisions

House Committee Report

[*Like-kind property used outside the U.S.*]

Restrict like-kind exchange rules for certain personal property.—The bill provides that personal property predominantly used within the United States and personal property predominantly used outside the United States are not "like-kind" properties. For this purpose, the use of the property surrendered in the exchange will be determined based upon the use during the 24 months immediately prior to the exchange. Similarly, for section 1031 to apply, property received in the exchange must continue in the same use (i.e., foreign or domestic) for the 24 months immediately after the exchange.

The 24-month period is reduced to such lesser time as the taxpayer held the property, unless such shorter holding period is a result of a transaction (or series of transactions) structured to avoid the purposes of the provision. Property described in section 168(g)(4) (generally, property used both within and without the United States that is eligible for accelerated depreciation as if used in the United States) will be treated as property predominantly used in the United States.

Effective date.—The provision is effective for exchanges after June 8, 1997, unless the exchange is pursuant to a binding contract in effect on such date and all times thereafter. A contract will not fail to be considered to be binding solely because (1) it provides for a sale in lieu of an exchange or (2) either the property to be disposed of as relinquished property or the property to be acquired as replacement property (whichever is applicable) was not identified under the contract before June 9, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,375] Act Sec. 1053. Law at ¶ 5265 and 5283. CCH Explanation at ¶ 917.

Revenue-Increase Provisions—Foreign

Senate Committee Report

[*Holding period for foreign taxes*]

Holding period requirement for certain foreign taxes.—The bill denies a shareholder the foreign tax credits normally available with respect to a dividend from a corporation or a regulated investment company ("RIC") if the shareholder has not held the stock for a minimum period during which it is not protected from risk of loss. Under the bill, the minimum holding period for dividends on common stock is 16 days. The minimum holding period for preferred stock is 46 days.

Where the holding period requirement is not met for stock of a foreign corporation, the bill disallows the foreign tax credits for the foreign withholding taxes that are paid with respect to a dividend. Such credits are denied both to the shareholder and any other taxpayer who would otherwise be entitled to claim foreign tax credits for such withholding taxes. In addition, the bill applies to all foreign tax credits otherwise allowable for taxes paid by a lower-tier foreign corporation and for foreign tax credits of a RIC that elects to treat its foreign taxes as paid by the shareholders. The bill denies such credits where any of the stock in the chain of ownership that is a requirement for claiming the credits is held for less than the required holding period.

The bill denies these same foreign tax credit benefits, regardless of the shareholder's holding period for the stock, to the extent that the taxpayer has an obligation to make payments related to the dividend (whether pursuant to a short sale or otherwise) with respect to substantially similar or related property.

The 16- or 46-day holding period under the bill (whichever applies) must be satisfied over a period immediately before or immediately after the shareholder becomes entitled to receive each dividend. For purposes of determining whether the required holding period is met, any period during which the shareholder has protected itself from risk of loss (under the rules of section 246(c)(4)) would not be included. For example, assume a taxpayer buys foreign common stock. Assume also that, the day after the stock is purchased, the taxpayer enters into an equity swap under which

the taxpayer is entitled to receive payments equal to the losses on the stock, and the taxpayer retains the swap position for the entire period it holds the stock. Under the bill, the taxpayer would not be able to claim any foreign tax credits with respect to dividends on the stock because the taxpayer's holding period is limited to the single day during which the loss on the stock was not protected. For purposes of entitlement to certain indirect foreign tax credits (secs. 902 and 960), the bill provides an exception from the risk reduction rule for a *bona fide* contract to sell stock.

The bill also provides an exception for foreign tax credits with respect to certain dividends received by active dealers in securities. In order to qualify for the exception, the following requirements must be met: (1) the dividend must be received by the entity on stock which it holds in its capacity as a dealer in securities, (2) the entity must be subject to net income taxation on the dividend (on either a residence or worldwide income basis) in a foreign country, and (3) the foreign taxes to which the exception applies must be taxes that are creditable under the foreign county's tax system. A securities dealer for purposes of the exception must be an entity which (1) is engaged in the active conduct of a securities business in a foreign country and (2) is registered as a securities broker or dealer under the Securities Exchange Act of 1934 or is licensed or authorized to conduct securities activities in such foreign county and subject to *bona fide* regulation by the securities regulatory authority of the foreign country. Under the bill, the Secretary of the Treasury is granted authority to issue regulations appropriate to prevent abuse of this exception.

If a taxpayer is denied foreign tax credits under the bill because the 16- or 46-day holding period requirement is not satisfied, the taxpayer would be entitled to a deduction for the foreign taxes for which the credit is disallowed. This deduction would be available even if the taxpayer claimed the foreign tax credit for other taxes in the same taxable year.

No inference is intended as to the treatment under present law of tax-motivated transactions intended to transfer foreign tax credit benefits.

Effective date.—The provision is effective for dividends paid or accrued more than 30 days after the date of enactment.

Conference Committee Report

The conference agreement generally follows the Senate amendment with one modification. The conference agreement grants regulatory authority to the Secretary of the Treasury to treat certain foreign taxes as not subject to the provision. The conferees anticipate that this authority may be used to address internal withholding taxes imposed by a foreign country on persons that do business in the foreign country.

[¶ 11,380] Act Sec. 1054. Law at ¶ 5281. CCH Explanation at ¶ 992.

Other Foreign Provisions

House Committee Report

[*Limit treaty benefits: Hybrid entities*]

Limitation on treaty benefits for payments to hybrid entities.—The bill limits the availability of a reduced rate of withholding tax pursuant to an income tax treaty in order to prevent tax avoidance. Under the bill, a foreign person is entitled to a reduced rate of withholding tax under a treaty with a foreign country on an item of income derived through an entity that is a partnership (or is otherwise treated as transparent) for U.S. tax purposes only if such item is treated for purposes of the taxation laws of such foreign country as an item of income of such person. This rule does not apply if the treaty itself contains a provision addressing the applicability of the treaty in the case of income derived through a partnership. Moreover, the rule does not apply if the foreign country imposes tax on an actual distribution of such item of income from such partnership to such person. In this regard, the foreign country will be considered to impose tax on a distribution even though such tax may be reduced or eliminated by reason of deductions or credits otherwise available to the taxpayer.

This bill addresses a potential tax-avoidance opportunity for Canadian corporations with U.S. subsidiaries that arises because of the interaction between the U.S. tax law, the Canadian tax law, and the income tax treaty between the United States and Canada. Through the use of a U.S. limited liability company, which is treated as a partnership for U.S. tax purposes but as a corporation for Canadian tax purposes, a payment of interest (which is deductible for U.S. tax purposes) may be converted into a dividend (which is excludable for Canadian tax purposes). Accordingly, interest paid by a U.S. subsidiary through a U.S. limited liability company to a Canadian parent corporation would be deducted by the U.S. subsidiary for U.S. tax purposes and would be excluded by the Canadian parent corporation for Canadian tax purposes; the only tax on such interest would be a U.S. withholding tax, which may be imposed at a reduced rate of 10 percent (rather

than the full statutory rate of 30 percent) pursuant to the income tax treaty between the United States and Canada. Under the bill, withholding tax is imposed at the full statutory rate of 30 percent in such case. The bill would not apply if the U.S.-Canadian income tax treaty is amended to include a provision reaching a similar result. In this regard, the United States and Canada recently negotiated a proposed protocol that would amend the provision in the treaty governing cross-border social security payments and this issue could be addressed in the context of that protocol or an additional protocol. Moreover, the bill would not apply if Canada were to impose tax on the Canadian parent on dividends received from the U.S. limited liability company.

The Committee believes that the provision generally is consistent with U.S. treaty obligations, including the U.S.-Canada treaty. The United States has recognized authority to implement its tax treaties so as to avoid abuses.

Effective date.—The provision is effective upon date of enactment.

Conference Committee Report

The conference agreement generally follows the House bill with a modification to provide regulatory authority to address the availability of treaty benefits in situations that involve hybrid entities but that are not covered by the denial of benefits specifically provided by the provision.

Under the conference agreement, a foreign person is not entitled to a reduced rate of withholding tax under a treaty with a foreign country on an item of income derived through an entity that is treated as a partnership (or is otherwise treated as fiscally transparent) for U.S. tax purposes if (i) such item is not treated for purposes of the taxation laws of such foreign country as an item of income of such person, (ii) the foreign country does not impose tax on an actual distribution of such item of income from such entity to such person, and (iii) the treaty itself does not contain a provision addressing the applicability of the treaty in the case of income derived through a partnership or other fiscally transparent entity. In addition, the conference agreement grants the Secretary of the Treasury authority to prescribe regulations to determine, in situations other than the situation specifically described in the statutory provision, the extent to which a taxpayer shall not be entitled to benefits under an income tax treaty of the United States with respect to any payment received by, or income attributable to activities of, an entity that is treated as a partnership for U.S. federal income tax purposes (or is otherwise treated as fiscally transparent for such purposes) but is treated as fiscally non-transparent for purposes of the tax laws of the jurisdiction of residence of the taxpayer.

The conferees note that on June 30, 1997 the Secretary issued proposed and temporary regulations addressing the availability of treaty benefits in cases involving hybrid entities. The conferees believe that these regulations are consistent with the provision in the conference agreement. The conferees also believe that the provision in the conference agreement and the temporary and proposed regulations are consistent with U.S. treaty obligations. Such provision and such regulations represent interpretations of U.S. treaties clarifying those situations involving hybrid entities in which taxpayers are entitled to treaty benefits and those situations in which they are not.

[¶ 11,385] Act Sec. 1055. Law at ¶ 5685 and 5687. CCH Explanation at ¶ 924.

Other Foreign Provisions

House Committee Report

[*Underpayment interest: FTC carryback*]

Interest on underpayment reduced by foreign tax credit carryback.—Under the bill, if an underpayment for a taxable year is reduced or eliminated by a foreign tax credit carryback from a subsequent taxable year, such carryback does not affect the computation of interest on the underpayment for the period ending with the filing date for such subsequent taxable year in which the foreign taxes were paid or accrued. The bill also clarifies the application of the interest rules of both section 6601 and section 6611 in the case of a foreign tax credit carryback that is triggered by a net operating loss or net capital loss carryback; in such a case, a deficiency is not considered to have been reduced, and an overpayment is not considered to have been created, until the filing date for the subsequent year in which the loss carryback arose. No inference is intended regarding the computation of interest under present law in the case of a foreign tax credit carryback (including a foreign tax credit carryback that is triggered by a net operating loss or net capital loss carryback).

Effective date.—The provision is effective for foreign taxes actually paid or accrued in taxable years beginning after date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,390] Act Sec. 1056. Law at ¶ 5681. CCH Explanation at ¶ 922.

Other Foreign Provisions

House Committee Report

[*FTC limitations period*]

Determination of period of limitations relating to foreign tax credits.—Under the bill, in the case of a claim relating to an overpayment attributable to foreign tax credits, the limitations period is determined by reference to the year in which the foreign taxes were paid or accrued (and not the year to which the foreign tax credits are carried). No inference is intended regarding the determination of such limitations period under present law.

Effective date.—The provision is effective for foreign taxes paid or accrued in taxable years beginning after date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,395] Act Sec. 1057. Law at ¶ 5035. CCH Explanation at ¶ 910.

Revenue-Increase Provisions—Foreign

Senate Committee Report

[*FTC limit: AMT*]

Repeal special exception to foreign tax credit limitation for alternative minimum tax purposes.—The special exception regarding the use of foreign tax credits for purposes of the alternative minimum tax, as provided by the 1989 Act, is repealed.

Effective date.—The provision is effective for taxable years beginning after the date of enactment.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 11,415] Act Sec. 1061. Law at ¶ 5227. CCH Explanation at ¶ 403.

Other Revenue-Increase Provisions

House Committee Report

[*Basis allocation: Partnership distributions*]

Allocation of basis of properties distributed to a partner by a partnership.—The provision modifies the basis allocation rules for distributee partners. It allocates a distributee partner's basis adjustment among distributed assets first to unrealized receivables and inventory items in an amount equal to the partnership's basis in each such property (as under present law).

Under the provision, basis is allocated first to the extent of each distributed property's adjusted basis to the partnership. Any remaining basis adjustment, if an increase, is allocated among properties with unrealized appreciation in proportion to their respective amounts of unrealized appreciation (to the extent of each property's appreciation), and then in proportion to their respective fair market values. For example, assume that a partnership with two assets, A and B, distributes them both in liquidation to a partner whose basis in its interest is 55. Neither asset consists of inventory or unrealized receivables. Asset A has a basis to the partnership of 5 and a fair market value of 40, and asset B has a basis to the partnership of 10 and a fair market value of 10. Under the provision, basis is first allocated to asset in the amount of 5 and to asset B in the amount of 10 (their adjusted bases to the partnership). The remaining basis adjustment is an increase totaling 40 (the partner's 55 basis minus the partnership's total basis in distributed assets of 15). Basis is then allocated to asset A in the amount of 35, its unrealized appreciation, with no allocation to asset B attributable to unrealized appreciation because its fair market value equals the partnership's adjusted basis. The remaining

basis adjustment of 5 is allocated in the ratio of the assets' fair market values, i.e., 4 to asset A (for a total basis of 44) and 1 to asset B (for a total basis of 11).

If the remaining basis adjustment is a decrease, it is allocated among properties with unrealized depreciation in proportion to their respective amounts of unrealized depreciation (to thin proportion to their respective adjusted bases (taking into account the adjustments already made). A remaining basis adjustment that is a decrease arises under the provision when the partnership's total adjusted basis in the distributed properties exceeds the amount of the partner's basis in its partnership interest, and the latter amount is the basis to be allocated among the distributed properties. For example, assume that a partnership with two assets, C and D, distributes them both in liquidation to a partner whose basis in its partnership interest is 20. Neither asset consists of inventory or unrealized receivables. Asset C has a basis to the partnership of 15 and a fair market value of 15, and asset D has a basis to the partnership of 15 and a fair market value of 5. Under the provision, basis is first allocated to the extent of the partnership's basis in each distributed property, or 15 to each distributed property, for a total of 30. Because the partner's basis in its interest is only 20, a downward adjustment of 10 (30 minus 20) is required. The entire amount of the 10 downward adjustment is allocated to the property D, reducing its basis to 5. Thus, the basis of property C is 15 in the hands of the distributee partner, and the basis of property D is 5 in the hands of the distributee partner.

Effective date.—The provision applies to partnership distributions after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,420] Act Sec. 1062. Law at ¶ 5223, 5225, 5227, 5229 and 5231. CCH Explanation at ¶ 410.

Other Revenue-Increase Provisions

House Committee Report

[*Partnership inventory items*]

Treatment of inventory items of a partnership.—The provision eliminates the requirement that inventory be substantially appreciated in order to give rise to ordinary income under the rules relating to sales and exchanges of partnership interests and certain partnership distributions. This conforms the treatment of inventory to the treatment of unrealized receivables under these rules.

Effective date.—The provision is effective for sales, exchanges, and distributions after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with modifications. The conference agreement repeals the requirement that inventory be substantially appreciated only with respect to sales or exchanges of partnership interests under section 751(a) of the Code, but not with respect to distributions under section 751(b) of the Code. Thus, present law is retained with respect to distributions governed by section 751(b).

Effective date.—The conference agreement follows the House bill and the Senate amendment, with a modification. The conference agreement provides that the provision is effective for sales, exchanges, and distributions after the date of enactment, except that the provision does not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such sale or exchange.

[¶ 11,425] Act Sec. 1063. Law at ¶ 5217 and 5230. CCH Explanation at ¶ 407.

Other Revenue-Increase Provisions

House Committee Report

[*Time for taxing pre-contribution gain*]

Treatment of appreciated property contributed to a partnership.—The provision extends to 10 years the period in which a partner recognizes pre-contribution gain with respect to property contributed to a partnership. Thus, under the provision, a partner that contributes appreciated property to a partnership generally recognizes pre-contribution gain in the event that the partnership distributes the contributed property to another partner, or distributes to the contributing partner other property whose value exceeds that partner's basis in its partnership interest, if the distribution occurs within 10 years after the contribution to the partnership.

Effective date.—The provision is effective for property contributed to a partnership after June 8, 1997.

Conference Committee Report

The conference agreement follows the House bill, with a modification. The conference agreement extends to 7 years the period in which a partner recognizes pre-contribution gain with respect to property contributed to a partnership. Thus, under the conference agreement, a partner that contributes appreciated property to a partnership generally recognizes pre-contribution gain in the event that the partnership distributes the contributed property to another partner, or distributes to the contributing partner other property whose value exceeds that partner's basis in its partnership interest, if the distribution occurs within 7 years after the contribution to the partnership.

Effective date.—The effective date is the same as the House bill, with a modification. The conference agreement is effective for property contributed to a partnership after June 8, 1997, except that the provision does not apply to any property contributed to a partnership pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such contribution, if the contract provides for the contribution of a fixed amount of property.

[¶ 11,445] Act Sec. 1071. Law at ¶ 5147, 5155, 5161 and 7031. CCH Explanation at ¶ 706.

Miscellaneous Provisions—Pensions and Other Benefits

House Committee Report (Code and Related Non-Code Provisions)

[*Cash out of accrued benefits*]

Cash out of certain accrued benefits.—The bill increases the limit on involuntary cash-outs to $5,000 from $3,500. The $5,000 amount is adjusted annually for inflation beginning after 1997 (in $50 increments).

Effective date.—The provision is effective for plan years beginning on and after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill, except the Senate amendment also makes a corresponding change to title I of ERISA and provides that the $5,000 amount is adjusted for inflation beginning after 1997 in $50 increments.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, except that the conference agreement does not increase the $5,000 limit for inflation.

[¶ 11,455] Act Sec. 1072. Law at ¶ 5055. CCH Explanation at ¶ 131.

Other Revenue-Increase Provisions

Senate Committee Report

[*Nontaxable parking benefits v. taxable cash*]

Election to receive taxable cash compensation in lieu of nontaxable parking benefits.—Under the bill, no amount is includible in the income of an employee merely because the employer offers the employee a choice between cash and employer-provided parking. The amount of cash offered is includible in income only if the employee chooses the cash instead of parking.

Effective date.—The provision is effective with respect to taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 11,465] Act Sec. 1073. Law at ¶ 5215, 5421, 5431, 5535 and 5577. CCH Explanation at ¶ 714.

Other Revenue-Increase Provisions

Senate Committee Report

[*Excess accumulation taxes*]

Repeal of excess distribution and excess retirement accumulation taxes.—The bill repeals both the 15-percent excise tax on excess distributions and the 15-percent estate tax on excess retirement accumulations.

Effective date.—The provision repealing the excess distribution tax is effective with respect to excess distributions received after December 31, 1996. The repeal of the excess accumulation tax is effective with respect to decedents dying after December 31, 1996.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 11,475] Act Sec. 1074. Law at ¶ 5529. CCH Explanation at ¶ 712.

Other Revenue-Increase Provisions

Senate Committee Report

[*Prohibited transactions*]

Tax on prohibited transactions.—The bill increases the initial-level prohibited transaction tax from 10-percent to 15-percent. No changes were made to the prohibited transaction provisions of title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

Effective date.—The provision is effective with respect to prohibited transactions occurring after the date of enactment.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 11,485] Act Sec. 1075. Law at ¶ 5041. CCH Explanation at ¶ 781.

Other Revenue-Increase Provisions

Senate Committee Report

[*Basis recovery rules*]

Basis recovery rules.—Under the bill, the present-law table would apply to benefits based on the life of one annuitant. A separate table would apply to benefits based on the life of more than one annuitant, as follows:

Combined age of annuitants:	*Number of payments:*
110 or less	410
111-120	360
121-130	310
131-140	260
141 and over	210

Effective date.—The provision is effective with respect to annuity starting dates beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment. As under the Senate amendment, a separate table applies to benefits based on the life of more than one annuitant, as follows:

Combined age of annuitants:	*Number of payments:*
Not more than 110	410
More than 110 but not more than 120	360
More than 120 but not more than 130	310
More than 130 but not more than 140	260
More than 140	210

The conference agreement clarifies that the new table applies to benefits based on the life of more than one annuitant, even if the amount of the annuity varies by annuitant. Thus, for example, the new table applies to a 50-percent joint and survivor annuity. The new table does not apply to an annuity paid on a single life merely because it has additional features, e.g., a term certain.

Effective date.—Same as the Senate amendment.

[¶ 11,515] Act Sec. 1081. Law at ¶ 5157. CCH Explanation at ¶ 365.

Other Revenue-Increase Provisions

Senate Committee Report

[*Suspense accounts: Family farm corporations*]

Phase out suspense accounts for certain large farm corporations.—The bill repeals the ability of a family farm corporation to establish a suspense account when it is required to change to an accrual method of accounting. Thus, under the bill, any family farm corporation required to change to an accrual method of accounting would restore the section 481 adjustment applicable to the change in gross income ratably over a 10-year period beginning with the year of change.

In addition, any taxpayer with an existing suspense account is required to restore the account into income ratably over a 20-year period beginning in the first taxable year beginning after June 8, 1997, subject to the present-law requirements to restore such accounts more rapidly. The amount required to be restored to income for a taxable year pursuant to the 20-year spread period shall not exceed the net operating loss of the corporation for the year (in the case of a corporation with a net operating loss) or 50 percent of the net income of the taxpayer for the year (for corporations with taxable income). For this purpose, a net operating loss or taxable income is determined without regard to the amount restored to income under the bill. Any reduction in the amount required to be restored to income is taken into account ratably over the remaining years in the 20-year period or, if applicable, after the end of the 20-year period. Amounts that extend beyond the 20-year period remain subject to the net operating loss and 50-percent-of- taxable income rules.

Finally, the present-law requirement that a portion of a suspense account be restored to income if the gross receipts of the corporation diminishes is repealed.

Effective date.—The provision is effective for taxable years ending after June 8, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment. In addition, the conferees wish to clarify that in the case of a family farm corporation that elects to be an S corporation for a taxable year, the net operating loss and 50 percent of taxable income limitations shall be determined by taking into account all the items of income, gain, deduction and loss of the corporation, whether or not such items are separately stated under section 1366.

[¶ 11,520] Act Sec. 1082. Law at ¶ 5079. CCH Explanation at ¶ 315.

Other Revenue-Increase Provisions

Senate Committee Report

[*NOL carryback and carryforward rules*]

Modify net operating loss carryback and carryforward rules.—The bill limits the NOL carryback period to two years and extends the NOL carryforward period to 20 years. The bill does not apply to the carryback rules relating to REITs, specified liability losses, excess interest losses, and corporate capital losses.

The bill does not apply to NOLs arising from casualty losses of individual taxpayers. In addition, the bill does not apply to NOLs attributable to losses incurred in Presidentially declared disaster areas by taxpayers engaged in a farming business or a small business. For this purpose, a "small business" means any trade or business (including one conducted in or through a corporation, partnership, or sole proprietorship) the average annual gross receipts (as determined under

sec. 448(c)) of which are $5 million or less, and a "farming business" is defined as in section 263A(e)(4).

Effective date.—The provision is effective for NOLs for taxable years beginning after the date of enactment. The provision does not apply to NOLs carried forward from prior taxable years.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 11,525] Act Sec. 1083. Law at ¶ 5017. CCH Explanation at ¶ 321.

Other Revenue-Increase Provisions

Conference Committee Report

[*Time periods for carrybck and carryforward of unused credits*]

Modify general business credit carryback and carryforward rules.—

Senate Amendment.—The Senate amendment limits the carryback period for the general business credit to one year and extends the carryforward period to 20 years.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Agreement.—The conference agreement includes the Senate amendment with a clarification that the provision is effective for credits arising in taxable years beginning after December 31, 1997.

[¶ 11,530] Act Sec. 1084. Law at ¶ 5043, 5097, 5099, 5247, 5249, 5251 and 5257. CCH Explanation at ¶ 845.

Other Revenue-Increase Provisions

House Committee Report

[*Life insurance, endowment and annuity contract deductions*]

Expand the limitations on deductibility of premiums and interest with respect to life insurance, endowment and annuity contracts.—

Expansion of premium deduction limitation to individuals in whom taxpayer has an insurable interest.—Under the provision, the present-law premium deduction limitation is modified to provide that no deduction is permitted for premiums paid on any life insurance, annuity or endowment contract, if the taxpayer is directly or indirectly a beneficiary under the contract.

Expansion of interest disallowance to individuals in whom taxpayer has insurable interest.—Under the provision, no deduction is allowed for interest paid or accrued on any indebtedness with respect to life insurance policy, or endowment or annuity contract, covering the life of any individual. Thus, the provision limits interest deductibility in the case of such a contract covering any individual in whom the taxpayer has an insurable interest when the contract is first issued under applicable State law, except as otherwise provided under present law with respect to key persons and pre-1986 contracts.

Pro rata disallowance of interest on debt to fund life insurance.—In the case of a taxpayer other than a natural person, no deduction is allowed for the portion of the taxpayer's interest expense that is allocable to unborrowed policy cash surrender values with respect to any life insurance policy or annuity or endowment contract issued after June 8, 1997. Interest expense is so allocable based on the ratio of (1) the taxpayer's average unborrowed policy cash values of life insurance policies, and annuity and endowment contracts, issued after June 8, 1997, to (2) the average adjusted bases for all assets of the taxpayer. This rule does not apply to any policy or contract owned by an entity engaged in a trade or business, covering any individual who is an employee, officer or director of the trade or business at the time first covered by the policy or contract. Such a policy or contract is not taken into account in determining unborrowed policy cash values.

The unborrowed policy cash values means the cash surrender value of the policy or contract determined without regard to any surrender charge, reduced by the amount of any loan with respect to the policy or contract. The cash surrender value is to be determined without regard to any other contractual or noncontractual arrangement that artificially depresses the cash value of a contract.

If a trade or business (other than a sole proprietorship or a trade or business of performing services as an employee) is directly or indirectly the beneficiary under any policy or contract, then the policy or contract is treated as held by the trade

or business. For this purpose, the amount of the unborrowed cash value is treated as not exceeding the amount of the benefit payable to the trade or business. In the case of a partnership or S corporation, the provision applies at the partnership or corporate level. The amount of the benefit is intended to take into account the amount payable to the business under the contract (e.g., as a death benefit) or pursuant to another agreement (e.g., under a split dollar agreement). The amount of the benefit is intended also to include any amount by which liabilities of the business would be reduced by payments under the policy or contract (e.g., when payments under the policy reduce the principal or interest on a liability owed to or by the business).

As provided in regulations, the issuer or policyholder of the life insurance policy or endowment or annuity contract is required to report the amount of the amount of the unborrowed cash value in order to carry out this rule.

If interest expense is disallowed under other provisions of section 264 (limiting interest deductions with respect to life insurance policies or endowment or annuity contracts) or under section 265 (relating to tax-exempt interest), then the disallowed interest expense is not taken into account under this provision, and the average adjusted bases of assets is reduced by the amount of debt, interest on which is so disallowed. The provision is applied before present-law rules relating to capitalization of certain expenses where the taxpayer produces property (sec. 263A).

An aggregation rule is provided, treating related persons as one for purposes of the provision.

The provision does not apply to any insurance company subject to tax under subchapter L of the Code. Rather, the rules reducing certain deductions for losses incurred, in the case of property and casualty companies, and reducing reserve deductions or dividends received deductions of life insurance companies, are modified to take into account the increase in cash values of life insurance policies or annuity or endowment contracts held by insurance companies.

Effective date.—The provisions apply with respect to contracts issued after June 8, 1997. For this purpose, a material increase in the death benefit or other material change in the contract causes the contract to be treated as a new contract. To the extent of additional covered lives under a contract after June 8, 1997, the contract is treated as a new contract. In the case of an increase in the death benefit of a contract that is converted to extended term insurance pursuant to nonforfeiture provisions, in a transaction to which section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 applies, the contract is not treated as a new contract.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with modifications.

Expansion of premium deduction limitation to individuals in whom taxpayer has an insurable interest.—The conference agreement provides that the premium deduction limitation does not apply to premiums with respect to any annuity contract described in section 72(s)(5) (relating to certain qualified pension plans, certain retirement annuities, individual retirement annuities, and qualified funding assets), nor to premiums with respect to any annuity to which section 72(u) applies (relating to current taxation of income on the contract in the case of an annuity contract held by a person who is not a natural person).

Expansion of interest disallowance to individuals in whom taxpayer has insurable interest.—The conference agreement specifies the treatment of certain interest to which the provision of the bill providing for expansion of interest disallowance to individuals in whom taxpayer has insurable interest otherwise would apply. The conference agreement provides that in the case of a transfer for valuable consideration of a life insurance contract or any interest therein described in section 101(a)(2), the amount of the death benefit excluded from gross income under section 101(a) may not exceed an amount equal to the sum of the actual value of the consideration, premiums, interest disallowed as a deduction under new section 264(a)(4), and other amounts subsequently paid by the transferee. Thus, under the provision, in the case of the transfer for value of a life insurance contract, the interest with respect to the contract that otherwise would be disallowed under new section 264(a)(4) is capitalized, reducing the amount included in income by the transferee upon receipt by the transferee of the amounts paid by reason of the death of the insured.

Pro rata disallowance of interest on debt to fund life insurance.—Under the pro rata interest disallowance provision of the bill, the conference agreement provides that interest expense is allocable to unborrowed policy cash values based on the ratio of (1) the taxpayer's average unborrowed policy cash values of life insurance policies, and annuity and endowment contracts, issued after June 8, 1997, to (2) the sum of (a) in the case of assets that are life insurance policies or annuity or endowment contracts, the average unborrowed policy cash values, and (b) in the case of other assets, the average adjusted bases for all such other assets of the taxpayer.

Under the pro rata interest disallowance rule, the conference agreement expands the exception for any policy or contract owned by an entity engaged in a trade or business, covering an individual who is an employee, officer or director of the trade or business at the time first covered. Under the conference agreement, the exception applies to any policy or contract owned by an entity engaged in a trade or business, which covers one individual who (at the time first insured under the policy or contract) is (1) a 20-percent owner of the entity, or (2) an individual (who is not a 20-percent owner) who is an officer, director or employee of the trade or business. The exception also applies in the case of a joint-life policy or contract under which the sole insureds are a 20-percent owner and the spouse of the 20-percent owner. A joint-life contract under which the sole insureds are a 20-percent owner and his or her spouse is the only type of policy or contract with more than one insured that comes within the exception. Thus, for example, if the insureds under a contract include an individual described in the exception (e.g., an employee, officer, director, or 20-percent owner) and any individual who is not described in the exception (e.g., a debtor of the entity), then the exception does not apply to the policy or contract. For purposes of this exception, a 20-percent owner has the same meaning as under present-law section 264(d)(4). In addition, the conference agreement provides that the pro rata interest disallowance rule does not apply to any annuity contract to which section 72(u) applies (relating to current taxation of income on the contract in the case of an annuity contract held by a person who is not a natural person). The conference agreement provides that any policy or contract that is not subject to the pro rata interest disallowance rule by reason of this exception (for 20-percent owners, their spouses, employees, officers and directors, and in the case of an annuity contract to which section 72(u) applies) is not taken into account in the applying the ratio to determine the portion of the taxpayer's interest expense that is allocable to unborrowed policy cash values.

The conferees wish to clarify that the aggregation rule (treating related persons as one for purposes of the provision) is intended to prevent taxpayers from avoiding the pro rata interest limitation by owning life insurance, endowment or annuity contracts, while incurring interest expense through a related person.

Treatment of insurance companies.—The conference agreement modifies the rules of the provision relating to the reduction of certain deductions of insurance companies. For purposes of those rules, an increase in the policy cash value for any policy or contract is (1) the amount of the increase in the adjusted cash value, reduced by (2) the gross premiums received with respect to the policy or contract during the taxable year, and increased by (3) distributions under the policy or contract to which section 72(e) apply (other than amounts includable in the policyholder's gross income). For this purpose, the adjusted cash value means the cash surrender value of the policy or contract, increased by (1) commissions payable with respect to the policy or contract for the taxable year, and (2) asset management fees, surrender and mortality charges, and any other fees or charges, specified in regulations, which are imposed (or would be imposed if the policy or contract were surrendered or canceled) with respect to the policy or contract for the taxable year.

Effective date.—The conferees wish to clarify the rule under the effective date providing that the addition of covered lives is treated as a new contract only with respect to such additional covered lives. It is intended that this rule apply with respect to a master or group policy or contract, not with respect to a joint-life policy or contract (i.e., a policy or contract that insures more than one individual).

[¶ 11,535] Act Sec. 1085(a)(1). Law at ¶ 5015. CCH Explanation at ¶ 127.

Other Revenue-Increase Provisions

House Committee Report

[*EIC eligibility denied*]

Earned income credit compliance provisions.—

Deny EIC eligibility for prior acts of recklessness or fraud.—A taxpayer who fraudulently claims the earned income credit (EIC) is ineligible to claim the EIC for a subsequent period of 10 years. In addition, a taxpayer who erroneously claims the EIC due to reckless or intentional disregard of rules or regulations is ineligible to claim the EIC for a subsequent period of two years. These sanctions are in addition to any other penalty imposed under present law. The determination of fraud or of reckless or intentional disregard of rules or regulations are made in a deficiency proceeding (which provides for judicial review).

Effective date.—The provision is effective for taxable years beginning after December 31, 1996.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,536] Act Sec. 1085(a)(2). Law at ¶ 5705. CCH Explanation at ¶ 127.

Other Revenue-Increase Provisions

House Committee Report

[*EIC compliance: Due diligence for paid preparers*]

Earned income credit compliance provisions.—

Due diligence requirements for paid preparers.—Return preparers are required to fulfill certain due diligence requirements with respect to returns they prepare claiming the EIC. The penalty for failure to meet these requirements is $100. This penalty is in addition to any other penalty imposed under present law.

Effective date.—The provision is effective for taxable years beginning after December 31, 1996.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,537] Act Sec. 1085(a)(3). Law at ¶ 5623. CCH Explanation at ¶ 127.

Other Revenue-Increase Provisions

House Committee Report

[*EIC compliance: Recertification*]

Earned income credit compliance provisions.—

Recertification required when taxpayer ineligible for EIC in past.—A taxpayer who has been denied the EIC as a result of deficiency procedures is ineligible to claim the EIC in subsequent years unless evidence of eligibility for the credit is provided by the taxpayer. To demonstrate current eligibility, the taxpayer is required to meet evidentiary requirements established by the Secretary of the Treasury. Failure to provide this information when claiming the EIC is treated as a mathematical or clerical error. If a taxpayer is recertified as eligible for the credit, the taxpayer is required to provide this information in the future unless the IRS again denies the EIC as a result of a deficiency procedure. Ineligibility for the EIC under the provision is subject to review by the courts.

Effective date.—The provision is effective for taxable years beginning after December 31, 1996.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,538] Act Sec. 1085(b) and 1085(d). Law at ¶ 5015. CCH Explanation at ¶ 127.

Other Revenue-Increase Provisions

Conference Committee Report

[*EIC compliance: Modify AGI for phaseout*]

Earned income credit compliance provisions.—

Modify the definition of AGI used to phaseout the EIC.—The conference agreement modifies the definition of AGI used for phasing out the credit by adding two items of nontaxable income and changing the percentage of certain losses disregarded. The two items added are: (1) tax-exempt interest, and (2) nontaxable distributions from pensions, annuities, and individual retirement arrangements (but only if not rolled over into similar vehicles during the applicable rollover period). The conference agreement also increases the amount of net losses from businesses, computed separately with respect to sole proprietorships (other than farming), sole proprietorships in farming, and other businesses disregarded from 50 percent to 75 percent.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

[¶ 11,539] Act Sec. 1085(c). Law at ¶ 5015. CCH Explanation at ¶ 127.

Other Revenue-Increase Provisions

Conference Committee Report

[*EIC: Workfare payments*]

Treatment of amounts received under the work requirements of the Personal Responsibility and Work Opportunity Act of 1996.—The conference agreement provides that workfare payments are not wages for purposes of the earned income credit. There is no inference intended with respect to whether workfare payments otherwise qualify as wages for purposes of income and employment taxes or as wages for purposes of an employer's eligibility for the work opportunity tax credit and the welfare-to-work tax credit. Also, there is no inference intended with respect to whether workfare payments are wages for purposes of the earned income credit before enactment of this provision.

Effective date.—The provision is effective on the date of enactment.

Enrollment Proceedings—Congressional Record

This enrolling resolution would make two corrections in the tax bill which just passed the House of Representatives, and that is H.R. 2014. The first correction would revise section 1085(c) to cover work experience and community service employment, but not subsidize private sector jobs.

Let me explain why this correction is necessary. The conference agreement intended to prohibit the payment of earned income tax credit to TANF recipients who were participating in workfare or community service jobs. However, the bill language denies the EITC to individuals in subsidized private employment or on-the-job training where the employer receives wage subsidy funds from the State that are financed by the TAIF funds, as well as to individuals in welfare or community service jobs. This problem appears to have stemmed from the fact that the drafters did not find a definition of the term "workfare, " in title IV-A. So they swept in a wide array of work activities, including subsidized private sector employment, and this concurrent resolution would put in place the intent of what Congress was acting to do.—House Ways and Means Committee Chairman Bill Archer.

[¶ 11,540] Act Sec. 1086. Law at ¶ 5073 and 5075. CCH Explanation at ¶ 325.

Other Revenue-Increase Provisions

House Committee Report

[*Income forecast method*]

Eligibility for income forecast method.—The bill clarifies the types of property to which the income forecast method may be applied. Under the bill, the income forecast method is available to motion picture films, television films and taped shows, books, patents, master sound recordings, copyrights, and other such property as designated by the Secretary of the Treasury. It is expected that the Secretary will exercise this authority such that the income forecast method will be available to property the economic depreciation of which cannot be adequately measured by the passage of time alone or to property the income from which is sufficiently unpredictable or uneven so as to result in the distortion of income. The mere fact that property is subject to a lease should not make the property eligible for the income forecast method. The income forecast method is not be applicable to property to which section 197 applies.

In addition, consumer durables subject to rent-to-own contracts are provided a three-year recovery period and a four-year class life for MACRS purposes (and would not be eligible for the income forecast method). Such property generally is described in Rev. Proc. 95-38, 1995-34 I.R.B. 25.

Effective date.—The provision is effective for property placed in service after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement generally follows the House bill and the Senate amendment, with modifications to depreciation applicable to qualified rent-to-own property. First, the conference agreement provides that the special 3-year recovery period may apply to any property generally used in the home for personal, but not business, use. The conferees understand that certain rent-to-own property, including computer and peripheral equipment, may be used in the home for either personal or business purposes, and the taxpayer may not be aware of how its customers may use the property. So as not to increase the administrative burdens of taxpayers,

the conferees intend that if such dual-use property does not represent a significant portion of a taxpayer's leasing property and if such other leasing property predominantly is qualified rent-to-own property, then such dual-use property generally also would be qualified rent-to-own property. However, if such dual-use property represents a significant portion of the taxpayer's leasing property, the conferees intend that the burden of proof be placed on the taxpayer to show that such property is qualified rent-to-own property.

In addition, the conference agreement modifies the definition of "rent-to-own contract" to include leases that provide for decreasing regular periodic payments.

Finally, the conferees wish to clarify that the 3-year recovery period provided under the provision only applies to property subject to leases and no inference is intended as to whether any arrangement constitutes a lease for tax purposes.

[¶ 11,545] Act Sec. 1087. Law at ¶ 5321. CCH Explanation at ¶ 334.

Other Revenue-Increase Provisions

House Committee Report

[*Involuntarily converted property: Related-party rule exception*]

Modify the exception to the related party rule of section 1033 for individuals to only provide an exception for de minimis amounts.—The bill expands the present-law denial of the application of section 1033 to any other taxpayer (including an individual) that acquires replacement property from a related party (as defined by secs. 267(b) and 707(b)(1)) unless the taxpayer has aggregate realized gain of $100,000 or less for the taxable year with respect to converted property with aggregate realized gains. In the case of a partnership (or S corporation), the annual $100,000 limitation applies to both the partnership (or S corporation) and each partner (or shareholder).

Effective date.—The provision applies to involuntary conversions occurring after June 8, 1997.

Conference Committee Report

Senate amendment.—The Senate agreement follows the House bill.

Conference agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,550] Act Sec. 1088. Law at ¶ 7034. CCH Explanation at ¶ 343.

Other Revenue-Increase Provisions

Senate Committee Report (Related Non-Code Provisions)

[*Manufacturer—dealer sales*]

Repeal of exception for certain sales by manufacturers to dealer.—The bill repeals the exception that permits the use of the installment method of accounting for certain sales by manufacturers to dealers.

Effective date.—The provision is effective for taxable years beginning one year after the date of enactment. Any resulting adjustment from a required change in accounting will be includible ratably over the 4-year taxable years beginning after that date.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 11,555] Act Sec. 1089. Law at ¶ 5203 and 5433. CCH Explanation at ¶ 281.

Other Revenue-Increase Provisions

Senate Committee Report

[*Charitable remainder trusts: Annual payouts*]

Treatment of charitable remainder trusts with greater than 50 percent annual payout.—Under the provision, a trust would not qualify as charitable remainder annuity trust if the annuity for a year is greater than 50 percent of the initial fair market value of the trust's assets or a trust would not qualify as a charitable remainder unitrust if the percentage of assets that are required to be distributed at least annually is greater than 50 percent. Any trust that fails this 50 percent rule will not be a charitable remainder trust whose taxation is governed under section 664, but will be treated as a complex trust and, accordingly, all of its income will be taxed to its beneficiaries or to the trust.

Effective date.—The provision applies to transfers to a trust made after June 18, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment with a modification that requires that the value of the charitable remainder with respect to any transfer to a qualified charitable remainder annuity trust or charitable remainder unitrust be at least 10 percent of the net fair market value of such property transferred in trust on the date of the contribution to the trust. The 10-percent test is measured on each transfer to the charitable remainder trust and, consequently, a charitable remainder trust which meets the 10-percent test on the date of transfer will not subsequently fail to meet that test if interest rates have declined between the trust's creation and the death of a measuring life. Similarly, where a charitable remainder trust is created for the joint lives of two individuals with a remainder to charity, the trust will not cease to qualify as a charitable remainder trust because the value of the charitable remainder was less than 10 percent of the trust's assets at the first death of those two individuals. The conference agreement provides several additional rules in order to provide relief for trusts that do not meet the 10-percent rule.

First, where a transfer is made after July 28, 1997, to a charitable remainder trust that fails the 10-percent test, the trust is treated as meeting the 10-percent requirement if the governing instrument of the trust is changed by reformation, amendment, construction, or otherwise to meet such requirement by reducing the payout rate or duration (or both) of any noncharitable beneficiary's interest to the extent necessary to satisfy such requirement so long as the reformation is commenced within the period permitted for reformations of charitable remainder trusts under section 2055(e)(3). The statute of limitations applicable to a deficiency of any tax resulting from reformation of the trust shall not expire before the date one year after the Treasury Department is notified that the trust has been reformed. In substance, this rule relaxes the requirements of section 2055(e)(3)(B) to the extent necessary for the reformation for the trust to meet the 10-percent requirement.

Second, a transfer to a trust will be treated as if the transfer never had been made where a court having jurisdiction over the trust subsequently declares the trust void (because, e.g., the application of the 10 percent rule frustrates the purposes for which the trust was created) and judicial proceedings to revoke the trust are commenced within the period permitted for reformations of charitable remainder trusts under section 2055(e)(3). Under this provision, the effect of "unwinding" the trust is that any transactions made by the trust with respect to the property transferred (e.g., income earned on the assets transferred to the trust and capital gains generated by the sales of the property transferred) would be income and capital gain of the donor (or the donor's estate if the trust was testamentary), and the donor (or the donor's estate if the trust was testamentary) would not be permitted a charitable deduction with respect to the transfer. The statute of limitations applicable to a deficiency of any tax resulting from "unwinding" the trust shall not expire before the date one year after the Treasury Department is notified that the trust has been revoked.

Third, where an additional contribution is made after July 28, 1997, to a charitable remainder unitrust created before July 29, 1997, and that unitrust would not meet the 10-percent requirement with respect to the additional contribution, the conference agreement provides that such additional contribution will be treated, under regulations to be issued by the Secretary of the Treasury, as if it had been made to a new trust that does not meet the 10-percent requirement, but which does not affect the status of the original unitrust as a charitable remainder trust.

The conferees intend that this provision of the conference agreement not limit or alter the validity of regulations proposed by the Treasury Department on April 18, 1997, or the Treasury Department's authority to address abuses of the rules governing the taxation of charitable remainder trusts or their beneficiaries.

Effective date.—The requirement that the payout rate not exceed 50 percent applies to transfers to a trust made after June 18, 1997.

The requirement that the value of the charitable remainder with respect to any transfer to a qualified remainder trust be at least 10 percent of the fair market value of the assets transferred in trust applies to transfers to a trust made after July 28, 1997. However, the 10-percent requirement does not apply to a charitable remainder trust created by a testamentary instrument (e.g., a will or revocable trust) executed before July 29, 1997, if the instrument is not modified after that date and the settlor dies before January 1, 1999, or could not be modified after July 28, 1997, because the settlor was under a mental disability on that date (i.e., July 28, 1997) and all times thereafter.

[¶ 11,560] Act Sec. 1090(a). Law at ¶ 7037. CCH Explanation at ¶ 1053.

Revenue-Increase Provisions

Conference Committee Report (Related Non-Code Provision)

[*Using child support orders for tax enforcement*]

Using Federal case registry of child support orders for tax enforcement purposes.—Not later than October 1, 1999, the Secretary of the Treasury will have access to the Federal Case Registry of Child Support Orders. Also, by October 1, 1999, the data elements on the State Case Registry will include the SSNs of children covered by cases in the Registry, and the States will provide the SSNs of these children to the FCR.

Effective date.—The provision is effective on October 1, 1999.

[¶ 11,563] Act Sec. 1090(b). Law at ¶ 7037. CCH Explanation at ¶ 1053.

Revenue-Increase Provisions

Conference Committee Report (Related Non-Code Provision)

[*Expand SSA records for tax enforcement*]

Expanded SSA records for tax enforcement.—SSA is required to obtain social security numbers (SSNs) of both parents on minor children's applications for SSNs. The SSA will provide this information to the IRS as part of the Data Master File ("DM-1 file"). The conferees anticipate that the IRS will use the information to identify questionable claims for the earned income credit, the dependent exemption, and other tax benefits, before tax refunds are paid out.

Effective date.—The provision is effective on the date of enactment.

[¶ 11,565] Act Sec. 1091. Law at ¶ 5693. CCH Explanation at ¶ 1103.

Savings an Investment Tax Incentives—Capital Gains

House Committee Report

[*Estimated tax requirements of individuals*]

Maximum rate of tax on net capital gain of individuals.—

* * * The provision also changes the 110-percent-of-last-year-liability estimated tax safe harbor to be a 109-percent-of-last-year liability safe harbor for 1997.

Conference Committee Report

The conference agreement changes the 110 percent of last year's liability safe harbor to be a 100 percent of last year's liability safe harbor for taxable years beginning in 1998, a 105 percent of last year's liability safe harbor for taxable years beginning in 1990, 2000 and 2001, and a 112 percent of last year's liability safe harbor for taxable years beginning in 2002. In addition, no estimated tax penalties will be imposed under section 6654 or 6655 for any period before January 1, 1998, for any payment the due date of which is before January 16, 1998, with respect to an underpayment to the extent the underpayment is created or increased by a provision of the Act.

[¶ 11,615] Act Sec. 1101. Law at ¶ 5287. CCH Explanation at ¶ 904.

Foreign Tax Provisions—General

House Committee Report

[*Individual FTC limit*]

Simplify foreign tax credit limitation for individuals.—The bill allows individuals with no more than $300 ($600 in the case of married persons filing jointly) of creditable foreign taxes, and no foreign source income other than passive income, an exemption from the foreign tax credit limitation rules. (The Committee intends that an individual electing this exemption will not be required to file Form 1116 in order to obtain the benefit of the foreign tax credit.) An individual making this election is not entitled to any carryover of excess foreign taxes to or from a taxable year to which the election applies.

For purposes of this election, passive income generally is defined to include all types of income that is foreign personal holding company income under the subpart F rules, plus income inclusions from foreign personal holding companies and passive foreign investment companies, provided that the income is shown on a payee statement furnished to the individual. For purposes of this

election, creditable foreign taxes include only foreign taxes that are shown on a payee statement furnished to the individual.

Effective date.—The provision applies to taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,620] Act Sec. 1102. Law at ¶ 5289, 5309 and 5313. CCH Explanation at ¶ 901.

Foreign Tax Provisions—General

Senate Committee Report

[*Simplify translation of foreign taxes*]

Translation of foreign taxes.—

Translation of certain accrued foreign taxes.—With respect to taxpayers that take foreign income taxes into account when accrued, the bill generally provides for foreign taxes to be translated at the average exchange rate for the taxable year to which such taxes relate. This rule does not apply (1) to any foreign income tax paid after the date two years after the close of the taxable year to which such taxes relate, (2) with respect to taxes of an accrual-basis taxpayer that are actually paid in a taxable year prior to the year to which they relate, or (3) to tax payments that are denominated in an inflationary currency (as defined by regulations).

Translation of all other foreign taxes.—Under the bill, foreign taxes not eligible for application of the preceding rule generally are translated into U.S. dollars using the exchange rates as of the time such taxes are paid. The bill provides the Secretary of the Treasury with authority to issue regulations that would allow foreign tax payments to be translated into U.S. dollar amounts using an average exchange rate for a specified period.

Redetermination of foreign taxes.—Under the bill, a redetermination is required if: (1) accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, (2) accrued taxes are not paid before the date two years after the close of the taxable year to which such taxes relate, or (3) any tax paid is refunded in whole or in part. Thus, for example, the bill provides that if at the close of the second taxable year after the taxable year to which an accrued tax relates, any portion of the tax so accrued has not yet been paid, a foreign tax redetermination under section 905(c) is required for the amount representing the unpaid portion of that accrued tax. In other words, the previous accrual of any tax that is unpaid as of that date is denied. In cases where a redetermination is required, as under present law, the bill specifies that the taxpayer must notify the Secretary, who will redetermine the amount of the tax for the year or years affected. In the case of indirect foreign tax credits, regulatory authority is granted to prescribe appropriate adjustments to the foreign tax credit pools in lieu of such a redetermination.

The bill provides that in the case of accrued taxes not paid within the date two years after the close of the taxable year to which such taxes relate, any such taxes if subsequently paid are taken into account for the taxable year to which such taxes relate. These taxes are translated into U.S. dollar amounts using the exchange rates in effect as of the time such taxes are paid.

For example, assume that in year 1 a taxpayer accrues 1,000 units of foreign tax that relate to year 1 and that the currency involved is not inflationary . Further assume that as of the end of year 1 the tax is unpaid. In this case, the bill provides that the taxpayer translates 1,000 units of accrued foreign tax into U.S. dollars at the average exchange rate for year 1. If the 1,000 units of tax are paid by the taxpayer in either year 2 or year 3, no redetermination of foreign tax is required. If any portion of the tax so accrued remains unpaid as of the end of year 3, however, the taxpayer is required to redetermine its foreign tax accrued in year 1 to eliminate the accrued but unpaid tax, thereby reducing its foreign tax credit for such year. If the taxpayer pays the disallowed taxes in year 4, the taxpayer again redetermines its foreign taxes (and foreign tax credit) for year 1, but the taxes paid in year 4 are translated into U.S. dollars at the exchange rate for year 4.

Effective date.—The provision generally is effective for foreign taxes paid (in the case of taxpayers using the cash basis for determining the foreign tax credit) or accrued (in the case of taxpayers using the accrual basis for determining the foreign tax credit) in taxable years beginning after December 31, 1997. The provision's changes to the foreign tax redetermination rules apply to foreign taxes which relate to taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment with one modification. The conference agreement clarifies that the regulatory authority applicable in the case of indirect foreign tax credits allows, in lieu of a redetermination of taxes, appropriate adjustments to the pools of post-1986 foreign income taxes and the pools of post-1986 undistributed earnings.

[¶ 11,625] Act Sec. 1103. Law at ¶ 5035. CCH Explanation at ¶ 907.

Foreign Tax Provisions—General

House Committee Report

[*Simplified FTC limit: AMT*]

Election to use simplified foreign tax credit limitation for alternative minimum tax purposes.—The provision permits taxpayers to elect to use as their AMT foreign tax credit limitation fraction the ratio of foreign source *regular* taxable income to entire alternative minimum taxable income, rather than the ratio of foreign source *alternative minimum* taxable income to entire alternative minimum taxable income. Under this election, foreign source regular taxable income is used, however, only to the extent it does not exceed entire alternative minimum taxable income. In the event that foreign source regular taxable income does exceed entire alternative minimum taxable income, and the taxpayer has income in more than one foreign tax credit limitation category, the Committee intends that the foreign source taxable income in each such category generally would be reduced by a pro rata portion of that excess.

The election is available only in the first taxable year beginning after December 31, 1997 for which the taxpayer claims an AMT foreign tax credit. The Committee intends that a taxpayer will be treated, for this purpose, as claiming an AMT foreign tax credit for any taxable year for which the taxpayer chooses to have the benefits of the foreign tax credit and in which the taxpayer is subject to the alternative minimum tax or would be subject to the alternative minimum tax but for the availability of the AMT foreign tax credit. The election, once made, will apply to all subsequent taxable years, and may be revoked only with the consent of the Secretary of the Treasury.

Effective date.—The provision applies to taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,630] Act Sec. 1104. Law at ¶ 5311. CCH Explanation at ¶ 953.

Foreign Tax Provisions—General

House Committee Report

[*Personal transactions in foreign currency*]

Simplify treatment of personal transactions in foreign currency.—If an individual acquires foreign currency and disposes of it in a personal transaction and the exchange rate changes between the acquisition and disposition of such currency, the provision applies nonrecognition treatment to any resulting exchange gain, provided that such gain does not exceed $200. The provision does not change the treatment of resulting exchange losses. The Committee understands that under other Code provisions such losses typically are not deductible by individuals (e.g., sec. 165(c)).

Effective date.—The provision applies to taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment with one modification. The conference agreement clarifies that transactions entered into in connection with a business trip constitute personal transactions for purposes of this provision. Exchange gain resulting from such transactions is eligible for nonrecognition treatment under this provision.

[¶ 11,635] Act Sec. 1105. Law at ¶ 5287. CCH Explanation at ¶ 915.

Foreign Tax Provisions—General

House Committee Report

[*FTC limit for 10/50 company dividends*]

Simplify foreign tax credit limitation for dividends from 10/50 companies.—Under the bill, a *single* foreign tax credit limitation generally applies to dividends received by the taxpayer from *all* 10/50 companies. However, separate foreign tax credit limitations continue to apply to dividends received by the taxpayer from each 10/50 company that qualifies as a passive foreign investment company. Regulatory authority is granted to provide rules regarding the treatment of distributions out of earning and profits for periods prior to the taxpayer's acquisition of such stock. To the extent the regulations treat distributions from a foreign corporation out of earnings and profits for pre-acquisition periods as subject to a separate foreign tax credit limitation, it is expected that the regulations would allow the taxpayer to elect to apply that separate foreign tax credit limitation (rather than the limitation applicable to dividends from all 10/50 companies) also to distributions out of post-acquisition earnings and profits of such corporation.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

Conference Committee Report

The conference agreement generally provides for look-through treatment to apply in characterizing dividends from 10/50 companies for foreign tax credit limitation purposes. Under the conference agreement, any dividend from a 10/50 company paid out of earnings and profits accumulated in a taxable year beginning after December 31, 2002 is treated as income in a foreign tax credit limitation category in proportion to the ratio of the earnings and profits attributable to income in such foreign tax credit limitation category to the total earnings and profits. Regulatory authority is granted to provide rules regarding the treatment of distributions out of earning and profits for periods prior to the taxpayer's acquisition of such stock.

In the case of dividends from a 10/50 company paid out of earnings and profits accumulated in a taxable year beginning before January 1, 2003, the conference agreement provides that a *single* foreign tax credit limitation generally applies to all such dividends from *all* 10/50 companies. However, separate foreign tax credit limitations continue to apply to any such dividends received by the taxpayer from each 10/50 company that qualifies as a passive foreign investment company. Regulatory authority is granted to provide rules regarding the treatment of distributions out of earning and profits for periods prior to the taxpayer's acquisition of such stock.

Effective date.—The provision is effective for taxable years beginning after December 31, 2002.

[¶ 11,655] Act Sec. 1111. Law at ¶ 5287 and 5307. CCH Explanation at ¶ 932.

Foreign Tax Provisions—CFCs

House Committee Report

[*Gain on stock sales by dividends*]

General provisions affecting treatment of controlled foreign corporations.—

Lower-tier CFCs—Characterization of gain on stock disposition.—Under the bill, if a CFC [controlled foreign corporation] is treated as having gain from the sale or exchange of stock in a foreign corporation, the gain is treated as a dividend to the same extent that it would have been so treated under section 1248 if the CFC were a U.S. person. This provision, however, does not affect the determination of whether the corporation whose stock is sold or exchanged is a CFC.

Thus, for example, if a U.S. corporation owns 100 percent of the stock of a foreign corporation, which owns 100 percent of the stock of a second foreign corporation, then under the bill, any gain of the first corporation upon a sale or exchange of stock of the second corporation is treated as a dividend for purposes of subpart F income inclusions to the U.S. shareholder, to the extent of earnings and profits of the second corporation attributable to periods in which the first foreign corporation owned the stock of the second foreign corporation while the latter was a CFC with respect to the U.S. shareholder.

Gain on disposition of stock in a related corporation created or organized under the laws of, and having a substantial part of its assets in a trade or business in, the same foreign country as the gain recipient, even if recharacterized as a dividend under the proposal, is not excluded from foreign personal holding company income under

the same-country exception that applies to actual dividends.

Under the bill, for purposes of this rule, a CFC is treated as having sold or exchanged stock if, under any provision of subtitle A of the Code, the CFC is treated as having gain from the sale or exchange of such stock. Thus, for example, if a CFC distributes to its shareholder stock in a foreign corporation, and the distribution results in gain being recognized by the CFC under section 311(b) as if the stock were sold to the shareholder for fair market value, the bill makes clear that, for purposes of this rule, the CFC is treated as having sold or exchanged the stock.

The bill also repeals a provision added to the Code by the Technical and Miscellaneous Revenue Act of 1988 that, except as provided by regulations, requires a recipient of a distribution from a CFC to have been a U.S. 10-percent shareholder of that CFC for the period during which the earnings and profits which gave rise to the distribution were generated in order to avoid treating the distribution as one coming from a 10/50 company. Thus, under the bill, a CFC is not treated as a 10/50 company with respect to any distribution out of its earnings and profits for periods during which it was a CFC, whether or not the recipient of the distribution was a U.S. 10-percent shareholder of the corporation when the earnings and profits giving rise to the distribution were generated.

* * *

Effective dates.—

Lower-tier CFCs.—The provision that treats gains on dispositions of stock in lower-tier CFCs as dividends under section 1248 principles applies to gains recognized on transactions occurring after the date of enactment.

The provision that expands look-through treatment, for foreign tax credit limitation purposes, of dividends form CFCs is effective for distributions after the date of enactment.

* * *

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,660] Act Sec. 1112. Law at ¶ 5295, 5297 and 5305. CCH Explanation at ¶ 937.

Foreign Tax Provisions—CFCs

House Committee Report

[*Miscellaneous modification to subpart F*]

General provisions affecting treatment of controlled foreign corporations.—

* * *

Adjustments to basis of stock.—Under the bill, when a lower-tier CFC earns subpart F income, and stock in that corporation is later disposed of by an upper-tier CFC, the resulting income inclusion of the U.S. 10-percent shareholders, under regulations, is to be adjusted to account for previous inclusions, in a manner similar to the adjustments provided to the basis of stock in a first-tier CFC. Thus, just as the basis of a U.S. 10-percent shareholder in a first-tier CFC rises when subpart F income is earned and falls when previously taxed income is distributed, so as to avoid double taxation of the income on a later disposition of the stock of that company, the subpart F income from gain on the disposition of a lower-tier CFC generally is reduced by income inclusions of earnings that were not subsequently distributed by the lower-tier CFC.

For example, assume that a U.S. person is the owner of all of the stock of a first-tier CFC which, in turn, is the sole shareholder of a second-tier CFC. In year 1, the second-tier CFC earns $100 of subpart F income which is included in the U.S. person's gross income for that year. In year 2, the first-tier CFC disposes of the second-tier CFC's stock and recognizes $300 of income with respect to the disposition. All of that income constitutes subpart F foreign personal holding company income. Under the bill, the Secretary is granted regulatory authority to reduce the U.S. person's year 2 subpart F inclusion by $100—the amount of year 1 subpart F income of the second-tier CFC that was included, in that year, in the U.S. person's gross income. Such an adjustment, in effect, allows for a step-up in the basis of the stock of the second-tier CFC to the extent of its subpart F income previously included in the U.S. person's gross income.

Subpart F inclusions in year of acquisition.—If a U.S. 10-percent shareholder acquires the stock of a CFC from another U.S. 10-percent shareholder during a taxable year of the CFC in which it earns subpart F income, the proposal reduces the acquiror's subpart F income inclusion for that year by a portion of the amount of the dividend deemed (under sec. 1248) to be received by the transferor. The portion by which the inclusion is reduced (as is the case if a dividend was paid to the previous owner of the stock) does not exceed the lesser of the amount of dividends with respect to such stock deemed received (under sec. 1248) by other persons during the year or the amount

determined by multiplying the subpart F income for the year by the proportion of the year during which the acquiring shareholder did not own the stock.

Treatment of U.S. income earned by a CFC.—Under the bill, an exemption or reduction by treaty of the branch profits tax that would be imposed under section 884 on a CFC does not affect the general statutory exemption from subpart F income that is granted for U.S. source effectively connected income. For example, assume a CFC earns income of a type that generally would be subpart F income, and that income is earned from sources within the United States in connection with business operations therein. Further assume that repatriation of that income is exempted from the U.S. branch profits tax under a provision of an applicable U.S. income tax treaty. The bill provides that, notwithstanding the treaty's effect on the branch tax, the income is not treated as subpart F income as long as it is not exempt from U.S. taxation (or subject to a reduced rate of tax) under any other treaty provision.

* * *

Effective dates.—

* * *

The provision that provides for regulatory adjustments to U.S. shareholder inclusions, with respect to gains of CFCs from dispositions of stock in lower-tier CFCs is effective for determining inclusions for taxable years of U.S. shareholders beginning after December 31, 1997. Thus, the bill permits regulatory adjustments to an inclusion occurring after the effective date to account for income that was previously taxed under the subpart F provisions either prior to or subsequent to the effective date.

Subpart F inclusions in year of acquisition.—The provision that permits dispositions of stock to be taken into consideration in determining a U.S. shareholder's subpart F inclusion for a taxable year is effective with respect to dispositions occurring after the date of enactment.

Treatment of U.S. source income earned by a CFC.—The provision concerning the effect of treaty exemptions from, or reductions of, the branch profits tax on the determination of subpart F income is effective for taxable years beginning after December 31, 1986.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,665] Act Sec. 1113. Law at ¶ 5285 and 5303. CCH Explanation at ¶ 934.

Foreign Tax Provisions—CFCs

House Committee Report

[*FTC for lower tier companies*]

General provisions affecting treatment of controlled foreign corporations.—

* * *

Extension of indirect foreign tax credit.—The bill extends the application of the indirect foreign tax credit (secs. 902 and 960) to taxes paid or accrued by certain fourth-, fifth-, and sixth-tier foreign corporations. In general, three requirements are required to be satisfied by a foreign company at any of these tiers to qualify for the credit. First, the company must be a CFC. Second, the U.S. corporation claiming the credit under section 902(a) must be a U.S. shareholder (as defined in sac. 951(b)) with respect to the foreign company. Third, the product of the percentage ownership of voting stock at each level from the U.S. corporation down must equal at least 5 percent. The bill limits the application of the indirect foreign tax credit below the third tier to taxes paid or incurred in taxable years during which the payor is a CFC. Foreign taxes paid below the sixth tier of foreign corporations remain ineligible for the indirect foreign tax credit.

Effective dates.—

* * *

Extension of indirect foreign tax credit.—The provision that extends application of the indirect foreign tax credit to certain CFCs below the third tier is effective for foreign taxes paid or incurred by CFCs for taxable years of such corporations beginning after the date of enactment.

In the case of any chain of foreign corporations, the taxes of which would be eligible for the indirect foreign tax credit, under present law or under the bill, but for the denial of indirect credits below the third or sixth tier, as the case may be, no liquidation, reorganization, or similar transaction in a taxable year beginning after the date of enactment will have the effect of permitting taxes to be taken into account under the indirect foreign tax credit provisions of the Code which could not have been taken into account under those provisions but for such transaction.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,685] Act Sec. 1121 and 1124. Law at ¶ 5367. CCH Explanation at ¶ 944.

Foreign Tax Provisions—Modification of PFIC Provisions

House Committee Report

[*U.S. shareholders of CFCs not subject to PFIC inclusion*]

Modification of passive foreign investment company provisions to eliminate overlap with subpart F and to allow mark-to-market election.—

Elimination of overlap between subpart F and the PFIC provisions.—In the case of a PFIC that is also a CFC, the bill generally treats the corporation as not a PFIC with respect to certain 10-percent shareholders. This rule applies if the corporation is a CFC (within the meaning of section 957(a)) and the shareholder is a U.S. shareholder (within the meaning of section 951(b)) of such corporation (i.e., if the shareholder is subject to the current inclusion rules of subpart F with respect to such corporation). Moreover, the rule applies for that portion of the shareholder's holding period with respect to the corporation's stock which is after December 31, 1997 and during which the corporation is a CFC and the shareholder is a U.S. shareholder. Accordingly, a shareholder that is subject to current inclusion under the subpart F rules with respect to stock of a PFIC that is also a CFC generally is not subject also to the PFIC provisions with respect to the same stock. The PFIC provisions continue to apply in the case of a PFIC that is also a CFC to shareholders that are not subject to subpart F (i.e., to shareholders that are U.S. persons and that own (directly, indirectly, or constructively) less than 10 percent of the corporation's stock by vote).

If a shareholder of a PFIC is subject to the rules applicable to nonqualified funds before becoming eligible for the special rules provided under the proposal for shareholders that are subject to subpart F, the stock held by such shareholder continues to be treated as PFIC stock unless the shareholder makes an election to pay tax and an interest charge with respect to the unrealized appreciation in the stock or the accumulated earnings of the corporation.

If, under the bill, a shareholder is not subject to the PFIC provisions because the shareholder is subject to subpart F and the shareholder subsequently ceases to be subject to subpart F with respect to the corporation, for purposes of the PFIC provisions, the shareholder's holding period for such stock is treated as beginning immediately after such cessation. Accordingly, in applying the rules applicable to PFICs that are not qualified electing funds, the earnings of the corporation are not attributed to the period during which the shareholder was subject to subpart F with respect to the corporation and was not subject to the PFIC provisions.

* * *

Effective date.—The provision is effective for taxable years of U.S. persons beginning after December 31, 1997, and taxable years of foreign corporations ending with or within such taxable years of U.S. persons.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment * * *

[¶ 11,690] Act Sec. 1122 and 1124. Law at ¶ 5183, 5185, 5187, 5263, 5363, 5365, 5367, 5369, 5371 and 5539. CCH Explanation at ¶ 946.

Foreign Tax Provisions—Modification of PFIC Provisions

House Committee Report

[*PFICs: Mark-to-market election*]

Modification of passive foreign investment company provisions to eliminate overlap with subpart F and to allow mark-to-market election.—

* * *

Mark-to-market election.—The bill allows a shareholder of a PFIC to make a mark-to-market election with respect to the stock of the PFIC, provided that such stock is marketable (as defined below). Under such an election, the shareholder includes in income each year an amount equal to the excess, if any, of the fair market value of the PFIC stock as of the close of the taxable year over the shareholder's adjusted basis in such stock. The

shareholder is allowed a deduction for the excess, if any, of the adjusted basis of the PFIC stock over its fair market value as of the close of the taxable year. However, deductions are allowable under this rule only to the extent of any net mark-to-market gains with respect to the stock included by the shareholder for prior taxable years.

Under the bill, this mark-to-market election is available only for PFIC stock that is "marketable." For this purpose, PFIC stock is considered marketable if it is regularly traded on a national securities exchange that is registered with the Securities and Exchange Commission or on the national market system established pursuant to section 11A of the Securities and Exchange Act of 1934. In addition, PFIC stock is considered marketable if it is regularly traded on any exchange or market that the Secretary of the Treasury determines has rules sufficient to ensure that the market price represents a legitimate and sound fair market value. Any option on stock that is considered marketable under the foregoing rules is treated as marketable, to the extent provided in regulations. PFIC stock also is treated as marketable, to the extent provided in regulations, if the PFIC offers for sale (or has outstanding) stock of which it is the issuer and which is redeemable at its net asset value in a manner comparable to a U.S. regulated investment company (RIC).

In addition, the bill treats as marketable any PFIC stock owned by a RIC that offers for sale (or has outstanding) any stock of which it is the issuer and which is redeemable at its net asset value. The bill treats as marketable any PFIC stock held by any other RIC that otherwise publishes net asset valuations at least annually, except to the extent provided in regulations. It is believed that even for RICs that do not make a market in their own stock, but that do regularly report their net asset values in compliance with the securities laws, inaccurate valuation may bring exposure to legal liabilities, and this exposure may ensure the reliability of the values such RICs assign to the PFIC stock they hold.

The shareholder's adjusted basis in the PFIC stock is adjusted to reflect the amounts included or deducted under this election. In the case of stock owned indirectly by a U.S. person through a foreign entity (as discussed below), the basis adjustments for mark-to-market gains and losses apply to the basis of the PFIC in the hands of the intermediary owner, but only for purposes of the subsequent application of the PFIC rules to the tax treatment of the indirect U.S. owner. In addition, similar basis adjustments are made to the adjusted basis of the property actually held by the U.S. person by reason of which the U.S. person is treated as owning PFIC stock.

Amounts included in income pursuant to a mark-to-market election, as well as gain on the actual sale or other disposition of the PFIC stock, is treated as ordinary income. Ordinary loss treatment also applies to the deductible portion of any mark-to-market loss on PFIC stock, as well as to any loss realized on the actual sale or other disposition of PFIC stock to the extent that the amount of such loss does not exceed the net mark-to-market gains previously included with respect to such stock. The source of amounts with respect to a mark-to-market election generally is determined in the same manner as if such amounts were gain or loss from the sale of stock in the PFIC.

An election to mark to market applies to the taxable year for which made and all subsequent taxable years, unless the PFIC stock ceases to be marketable or the Secretary of the Treasury consents to the revocation of such election.

Under constructive ownership rules, U.S. persons that own PFIC stock through certain foreign entities may make this election with respect to the PFIC. These constructive ownership rules apply to treat PFIC stock owned directly or indirectly by or for a foreign partnership, trust, or estate as owned proportionately by the partners or beneficiaries, except as provided in regulations. Stock in a PFIC that is thus treated as owned by a person is treated as actually owned by that person for purposes of again applying the constructive ownership rules. In the case of a U.S. person that is treated as owning PFIC stock by application of this constructive ownership rule, any disposition by the U.S. person or by any other person that results in the U.S. person being treated as no longer owning the PFIC stock, as well as any disposition by the person actually owning the PFIC stock, is treated as a disposition by the U.S. person of the PFIC stock.

In addition, a CFC that owns stock in a PFIC is treated as a U.S. person that may make the election with respect to such PFIC stock. Any amount includible (or deductible) in the CFC's gross income pursuant to this mark-to-market election is treated as foreign personal holding company income (or a deduction allocable to foreign personal holding company income). The source of such amounts, however, is determined by reference to the actual residence of the CFC.

In the case of a taxpayer that makes the mark-to-market election with respect to stock in a PFIC that is a nonqualified fund after the beginning of the taxpayer's holding period with respect to such stock, a coordination rule applies to ensure that the taxpayer does not avoid the interest charge with respect to amounts attributable to periods before such election. A similar rule applies to RICs that make the mark-to-market election under this bill after the beginning of their holding period with respect to PFIC stock (to the extent that the RIC had not previously marked to market the stock of the PFIC).

Except as provided in the coordination rules described above, the rules of section 1291 (with

respect to nonqualified funds) do not apply to a shareholder of a PFIC if a mark-to-market election is in effect for the shareholder's taxable year. Moreover, in applying section 1291 in a case where a mark-to-market election was in effect for any prior taxable year, the shareholder's holding period for the PFIC stock is treated as beginning immediately after the last taxable year for which such election applied.

A special rule applicable in the case of a PFIC shareholder that becomes a U.S. person treats the adjusted basis of any PFIC stock held by such person on the first day of the year in which such shareholder becomes a U.S. person as equal to the greater of its fair market value on such date or its adjusted basis on such date. Such rule applies only for purposes of the mark-to-market election.

Effective date.—The provision is effective for taxable years of U.S. persons beginning after December 31, 1997, and taxable years of foreign corporations ending with or within such taxable years of U.S. persons.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment * * *

[¶ 11,695] Act Sec. 1123 and 1124. Law at ¶ 5369. CCH Explanation at ¶ 948.

Foreign Tax Provisions—Modification of PFIC Provisions

Conference Committee Report

[*PFICs: Valuation of assets*]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment with one modification to the rules regarding the measurement of assets for purposes of applying the PFIC asset test. Under the conference agreement, if the stock of a foreign corporation is publicly traded for the taxable year, the PFIC asset test is applied using fair market value for purposes of measuring the PFIC's assets. For this purpose, the stock of a foreign corporation is treated as publicly traded if such stock is readily tradeable on a national securities exchange that is registered with the Securities and Exchange Commission, the national market system established pursuant to section 11A of the Securities and Exchange Act of 1934, or any other exchange or market that the Secretary of the Treasury determines has rules sufficient to ensure that the market price represents a sound fair market value. Because the PFIC asset test is applied based on quarterly measurements of the corporation's assets, it is intended that a corporation the stock of which is publicly traded on each such quarterly measurement date during the taxable year will be eligible for this asset measurement rule for such taxable year. In applying the PFIC asset test, it is intended that the total value of a publicly-traded foreign corporation's assets generally will be treated as equal to the sum of the aggregate value of its outstanding stock plus its liabilities.

The conference agreement does not change the rules applicable to non-publicly-traded foreign corporations for purposes of the measurement of assets in applying the PFIC asset test. Accordingly, CFCs that are not publicly traded continue to be required to measure their assets using adjusted basis, and any other foreign corporations that are not publicly traded continue to measure their assets using fair market value unless they elect to use adjusted basis.

[Note: *Effective date.*—The provision is effective for taxable years of U.S. persons beginning after December 31, 1997, and taxable years of foreign corporations ending with or within such taxable years of U.S. persons. Act Sec. 1124.—CCH]

[¶ 11,735] Act Sec. 1131. Law at ¶ 5127, 5211, 5221, 5253, 5325, 5335, 5409, 5412, 5415 and 5671. CCH Explanation at ¶ 968 and 969.

Foreign—Related Simplification Provisions

Senate Committee Report

[*Transfers to foreign entities*]

Simplify formation and operation of international joint ventures.—The bill repeals the sections 1491-1494 excise tax rules that apply to certain transfers of appreciated property by a U.S. person to a foreign entity. Instead of the excise tax that applies under present law to transfers to a foreign estate or trust, gain recognition is required upon a transfer of appreciated property by a U.S. person to a foreign estate or trust. Instead of the excise tax that applies under present law to certain transfers to foreign corpora-

tions, regulatory authority is granted under section 367 to deny nonrecognition treatment to such a transfer in a transaction that is not otherwise described in section 367. Instead of the excise tax that applies under present law to transfers to foreign partnerships, regulatory authority is granted to provide for gain recognition on a transfer of appreciated property to a partnership in cases where such gain otherwise would be transferred to a foreign partner. In addition, regulatory authority is granted to deny the nonrecognition treatment that is provided under section 1035 to certain exchanges of insurance policies, where the transfer is to a foreign person.

The bill repeals the rule that treats as U.S. source income any deemed royalty arising under section 367(d). Under the bill, in the case of a transfer of intangible property to a foreign corporation, the deemed royalty payments under section 367(d) are treated as foreign source income to the same extent that an actual royalty payment would be considered to be foreign source income. Regulatory authority is granted to provide similar treatment in the case of a transfer of intangible property to a foreign partnership.

* * *

Effective date.—The provisions with respect to the repeal of sections 1491-1494 are effective upon date of enactment. The provisions with respect to the source of a deemed royalty under section 367(d) also are effective for transfers made and royalties deemed received after date of enactment.

* * *

Conference Committee Report

The conference agreement generally follows the Senate amendment with modifications.

The conference agreement clarifies that, for purposes of the requirement of gain recognition upon a transfer of appreciated property by a U.S. person to a foreign estate or trust, a U.S. trust that becomes a foreign trust is treated as having transferred all of its assets to a foreign trust.

The conference agreement further clarifies that, in the case of a transfer by a U.S. person to a foreign corporation as paid-in surplus or as a contribution to capital in a transaction not otherwise described in section 367 (e.g., a capital contribution by a non-shareholder), regulatory authority is granted under section 367 to treat such transfer as a fair market value sale and to require gain recognition thereon.

* * *

[¶ 11,755] Act Sec. 1141. Law at ¶ 5581 and 5637. CCH Explanation at ¶ 981.

Foreign-Related Simplification Provisions

Senate Committee Report

[*Foreign partnership return requirement*]

Simplify formation and operation of international joint ventures.—

* * *

The bill provides detailed information reporting rules in the case of foreign partnerships. A foreign partnership generally is required to file a partnership return for a taxable year if the partnership has U.S. source income or is engaged in a U.S. trade or business, except to the extent provided in regulations.

* * *

Effective date.—

* * * The provisions regarding information reporting with respect to foreign partnerships generally are effective for partnership taxable years beginning after date of enactment. * * *

Conference Committee Report

The conference agreement generally follows the Senate amendment with modifications.

* * *

[¶ 11,760] Act Sec. 1142. Law at ¶ 5115, 5283 and 5587. CCH Explanation at ¶ 983.

Foreign-Related Simplification Provisions

Senate Committee Report

[*CFPs subject to CFC reporting rules*]

Simplify formation and operation of international joint ventures.—

* * *

Under the bill, reporting rules similar to those applicable under present law in the case of controlled foreign corporations apply in the case of foreign partnerships. A U.S. partner that controls a foreign partnership is required to file an annual information return with respect to such partnership. For this purpose, a U.S. partner is considered to control a foreign partnership if the partner

holds a more than 50 percent or greater interest in the capital, profits, or, to the extent provided in regulations, losses, of the partnership. Similar information reporting also will be required from a U.S. 10-percent partner of a foreign partnership that is controlled by U.S. 10-percent partners. A $10,000 penalty applies to a failure to comply with these reporting requirements; additional penalties of up to $50,000 apply in the case of continued noncompliance after notification by the Secretary of the Treasury. Under the bill, the penalties for failure to report information with respect to a controlled foreign corporation are conformed with these penalties.

* * *

Effective date.—* * * [Note: The provisions regarding information reporting with respect to controlled foreign partnerships are effective for annual accounting periods beginning after the date of enactment. Act Sec. 1142(f).—CCH]

Conference Committee Report

The conference agreement generally follows the Senate amendment with modifications.

* * *

For purposes of the information reporting rules applicable to a U.S. partner that controls a foreign partnership, the conference agreement clarifies that a partner's interest in a partnership is determined with application of constructive ownership rules similar to those provided in section 267(c) (other than paragraph (3)).

* * *

[¶ 11,765] Act Sec. 1143. Law at ¶ 5601 and 5699. CCH Explanation at ¶ 985 and ¶ 986.

Foreign-Related Simplification Provisions

Senate Committee Report

[*Information reporting for changes in foreign partnership interests*]

Simplify formation and operation of international joint ventures.—

* * *

Under the bill, reporting by a U.S. person of an acquisition or disposition of an interest in a foreign partnership, or a change in the person's proportional interest in the partnership, is required only in the case of acquisitions, dispositions, or changes involving at least a 10-percent interest. A $10,000 penalty applies to a failure to comply with these reporting requirements; additional penalties of up to $50,000 apply in the case of continued noncompliance after notification by the Secretary. Under the bill, the penalties for failure to report information with respect to a foreign corporation are conformed with these penalties.

* * *

Effective date.—

* * * The provisions regarding information reporting with respect to interests in, and transfers to, foreign partnerships are effective for transfers to, and changes in interest in, foreign partnerships after date of enactment. * * *

Conference Committee Report

The conference agreement generally follows the Senate amendment with modifications.

* * *

[¶ 11,770] Act Sec. 1144. Law at ¶ 5589. CCH Explanation at ¶ 988.

Foreign-Related Simplification Provisions

Senate Committee Report

[*Reporting on transfers to foreign partnerships and corporations*]

Simplify formation and operation of international joint ventures.—

* * *

Under the bill, reporting rules similar to those applicable under present law in the case of transfers by U.S. persons to foreign corporations apply in the case of transfers to foreign partnerships. These reporting rules apply in the case of a transfer to a foreign partnership only if the U.S. person holds at least a 10-percent interest in the partnership or the value of the property transferred by such person to the partnership during a 12-month period exceeded $100,000. A penalty equal to 10 percent of the value of the property transferred applies to a failure to comply with these reporting requirements. Under the bill, the penalty under present law for failure to report transfers to a foreign corporation is conformed with this penalty. In the case of a transfer to a foreign partnership, failure to comply also results in gain

recognition with respect to the property transferred.

* * *

Effective date.—

* * * The provisions regarding information reporting with respect to interests in, and transfers to, foreign partnerships are effective for transfers to, and changes in interest in, foreign partnerships after date of enactment. Taxpayers may elect to apply these rules to transfers made after August 20, 1996 (and thereby avoid a penalty under section 1494(c)) and the Secretary may prescribe simplified reporting requirements for these cases. * * *

The conference agreement generally follows the Senate amendment with modifications.

* * *

[¶ 11,775] Act Sec. 1145. Law at ¶ 5675. CCH Explanation at ¶ 971.

Foreign-Related Simplification Provisions

Senate Committee Report

[*Statute of limitations for foreign transfers*]

Simplify formation and operation of international joint ventures.—

* * *

Under the bill, in the case of a failure to report required information with respect to a foreign corporation, partnership, or trust, the statute of limitations with respect to any event or period to which such information relates not expire before the date that is three years after the date on which such information is provided.

* * *

Effective date.—

* * * The provision with respect to the statute of limitations in the case of noncompliance with reporting requirements is effective for information returns due after date of enactment.

Conference Committee Report

The conference agreement generally follows the Senate amendment with modifications.

* * *

[¶ 11,780] Act Sec. 1146. Law at ¶ 5601. CCH Explanation at ¶ 990.

Foreign Tax Provisions

House Committee Report

[*Reporting threshold: Foreign corporation stock*]

Modification of reporting threshold for stock ownership of a foreign corporation.—The bill increases the threshold for stock ownership of a foreign corporation that results in information reporting obligations under section 6046 from 5 percent (based on value) to 10 percent (based on vote or value).

Effective date.—The provision is effective for reportable transactions occurring after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,815] Act Sec. 1151. Law at ¶ 5745. CCH Explanation at ¶ 467.

Foreign-Related Simplification Provisions

Senate Committee Report

[*Foreign or domestic partnership determination*]

Simplify formation and operation of international joint ventures.—

* * *

Under the bill, regulatory authority is granted to provide rules treating a partnership as a foreign partnership where such treatment is more appropriate. It is expected that a recharacterization of a partnership as foreign rather than domestic under such regulations will be based only on material factors such as the residence of the partners and the extent to which the partnership is engaged in business in the United States or earns U.S. source income. It also is expected that such regulations will provide guidance regarding the determination of whether an entity that is a partnership for Federal income tax purposes is to be considered to be created or organized in the

United States or under the law of the United States or any State.

Effective date.—* * *

The provision granting regulatory authority with respect to the treatment of partnerships as foreign or domestic is effective for partnership taxable years beginning after date of enactment.

Conference Committee Report

The conference agreement generally follows the Senate amendment with modifications.

* * *

Finally, the conference agreement provides that regulations issued under the grant of regulatory authority to provide rules treating a partnership as a domestic or foreign partnership will apply only to partnerships created or organized after the date such regulations are filed with the Federal Register (or, if earlier, the date of a public notice substantially describing the expected contents of the regulations). Accordingly, regulations issued under this grant of regulatory authority will not be applied to reclassify pre-existing partnerships. In connection with this regulatory authority, the conferees wish to make clear that it is intended that the general rule for classifying a partnership as domestic or foreign will continue to be the place where the partnership is created or organized (or the laws under which it is created or organized), and that the regulations are expected to provide a different classification result only in unusual cases. The conferees also expect that any regulations will avoid period-by-period reclassifications of partnerships.

[¶ 11,835] Act Sec. 1161. Law at ¶ 7040. CCH Explanation at ¶ 973.

Other Foreign Simplification Provisions

House Committee Report (Related Non-Code Provisions)

[*Trust transition rules*]

Transition rules for certain trusts.—Under the bill, the Secretary of the Treasury is granted authority to allow nongrantor trusts that had been treated as U.S. trusts under prior law to elect to continue to be treated as U.S. trusts, notwithstanding the new criteria for qualification as a U.S. trust.

Effective date.—The provision is effective for taxable years beginning after December 31, 1996.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,840] Act Sec. 1162. Law at ¶ 5277. CCH Explanation at ¶ 955.

Other Foreign Simplification Provisions

House Committee Report

[*Stock and securities trading safe harbor*]

Simplify application of the stock and securities trading safe harbor.—The bill modifies the stock and securities trading safe harbor by eliminating the requirement for both partnerships and foreign corporations that trade stock or securities for their own account that the entity's principal office not be within the United States.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement folows the House bill and the Senate amendment.

[¶ 11,845] Act Sec. 1163(a) and (c). Law at ¶ 5285. CCH Explanation at ¶ 919.

Other Foreign Provisions

House Committee Report

[*Foreign taxes deemed paid*]

Clarification of determination of foreign taxes deemed paid.—The bill clarifies that the exclusion of income that is treated as high-taxed income does not apply for purposes of the separate foreign tax credit limitation applicable to financial services income. No inference is intended regarding the treatment of high-taxed income for purposes of the separate foreign tax credit limitation applicable to financial services income under present law.

Effective date.—The provision is effective on date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,850] Act Sec. 1163(b) and (c). Law at ¶ 5287. CCH Explanation at ¶ 912.

Other Foreign Provisions

House Committee Report

[*FTC limit for financial services income*]

Clarification of foreign tax credit limitation for financial services income.—The bill clarifies that, for purposes of the deemed paid credit under section 902 for a taxable year, a foreign corporation's post-1986 foreign income taxes includes foreign income taxes with respect to prior taxable years (beginning after December 31, 1986) only to the extent such taxes are not attributable to dividends distributed by the foreign corporation in prior taxable years. No inference is intended regarding the determination of foreign taxes deemed paid under present law.

Effective date.—The provision is effective on date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 11,865] Act Sec. 1171. Law at ¶ 5293. CCH Explanation at ¶ 950.

Miscellaneous Provisions—Foreign Tax

Senate Committee Report

[*FSC benefits: Computer software licenses*]

Eligibility of licenses of computer software for foreign sales corporation benefits.—The bill provides that computer software licensed for reproduction abroad is *not* excluded from the definition of export property for purposes of the FSC provisions. Accordingly, computer software that is exported with a right to reproduce is eligible for the benefits of the FSC provisions. In light of the rapid innovations in the computer and software industries, the Committee intends that the term "computer software" be construed broadly to accommodate technological changes in the products produced by both industries. No inference is intended regarding the qualification as export property of computer software licensed for reproduction abroad under present law.

Effective date.—The provision applies to gross receipts from computer software licenses attributable to periods after December 31, 1997. Accordingly, in the case of a multi-year license, the provision applies to gross receipts attributable to the period of such license that is after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 11,870] Act Sec. 1172. Law at ¶ 5291. CCH Explanation at ¶ 133.

Foreign Tax Provisions—General

House Committee Report

[*Code Sec. 911 exclusion dollar limit*]

Increase dollar limitation on section 911 exclusion.—Under the bill, the $70,000 limitation on the exclusion for foreign earned income is increased to $80,000, in increments of $2,000 each year beginning in 1998. Under the bill, the limitation on the exclusion for foreign earned income then is indexed for inflation beginning in 2008 (for inflation after 2006).

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 11,875] Act Sec. 1173. Law at ¶ 5301. CCH Explanation at ¶ 940.

Miscellaneous Provisions—Foreign Tax

Senate Committee Report

[*Subpart F investment rules: Securities positions*]

Treatment of certain securities positions under the subpart F investment in U.S. property rules.—The bill provides two additional exceptions from the definition of U.S. property for purposes of the subpart F rules. Both exceptions relate to transactions entered into by a securities or commodities dealer in the ordinary course of its business as a securities or commodities dealer.

The first exception covers the deposit of collateral or margin by a securities or commodities dealer, or the receipt of such a deposit by a securities or commodities dealer, if such deposit is made or received on commercial terms in the ordinary course of the dealer's business as a securities or commodities dealer. This exception applies to deposits of margin or collateral for securities loans, notional principal contracts, options contracts, forward contracts, futures contracts, and any other financial transaction with respect to which the Secretary of the Treasury determines that the posting of collateral or margin is customary.

The second exception covers repurchase agreement transactions and reverse repurchase agreement transactions entered into by or with a securities or commodities dealer in the ordinary course of its business as a securities or commodities dealer. The exception applies only to the extent that the obligation under the transaction does not exceed the fair market value of readily marketable securities transferred or otherwise posted as collateral.

Effective date.—The provision is effective for taxable years of foreign corporations beginning after December 31, 1997, and taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

Conference Committee Report

The conference agreement generally follows the Senate amendment. Under the conference agreement, for purposes of these two additional exceptions under section 956, the term "dealer in commodities" means futures commission merchants and dealers in commodities within the meaning of the new definition that is added to section 475 by the conference agreement. In addition, the conferees wish to clarify that the addition of these two exceptions under section 956 is not intended to create any inference regarding the treatment of an obligation of a U.S. person to return stock that is borrowed pursuant to a securities loan.

[¶ 11,880] Act Sec. 1174. Law at ¶ 5275 and 5745. CCH Explanation at ¶ 965.

Miscellaneous Provisions—Foreign Tax

Senate Committee Report

[*Service income of nonresident aliens*]

Treat service income of nonresident alien individuals earned on foreign ships as foreign source income and disregard the U.S. presence of such individuals.—The bill treats gross income of a nonresident alien individual, who is present in the United States as a member of the regular crew of a foreign vessel, from the performance of personal services in connection with the international operation of a ship as income from foreign sources. Thus, such income is exempt from U.S. income and withholding tax. However, such persons are

not excluded for purposes of applying the minimum participation standards of section 410 to a plan of the employer. In addition, for purposes of determining whether an individual is a U.S. resident under the substantial presence test, the bill provides that the days that such individual is present as a member of the regular crew of a foreign vessel are disregarded.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement generally follows the Senate amendment with modifications. The conference agreement provides that the treatment of income of a nonresident alien crew member of a foreign vessel as foreign source income will not apply for purposes of the pension rules and certain employee benefit provisions. The conference agreement further provides that, for purposes of determining whether an individual is a U.S. resident under the substantial presence test, any day that such individual is present as a member of the regular crew of a foreign vessel is disregarded only if the individual does not otherwise engage in trade or business within the United States on such day.

[¶ 11,885] Act Sec. 1175. Law at ¶ 5299. CCH Explanation at ¶ 942.

Miscellaneous Provisions—Foreign Tax

Senate Committee Report

[*FPHC exception: Active financing income*]

Exception from foreign personal holding company income under subpart F for active financing income.—The bill provides a temporary exception from foreign personal holding company income for subpart F purposes for certain income that is derived in the active conduct of an insurance, banking, financing or similar business. Such exception is applicable only for taxable years beginning in 1998.

Under the bill, foreign personal holding company income does not include income that is derived in or incident to the active conduct of a banking, financing or similar business by a CFC that is predominantly engaged in the active conduct of such business. For this purpose, income derived in the active conduct of a banking, financing, or similar business generally is determined under the principles applicable in determining financial services income for foreign tax credit limitation purposes. Moreover, the Secretary of the Treasury shall prescribe regulations applying look-through treatment in characterizing for this purpose dividends, interest, income equivalent to interest, rents, and royalties from related persons. A CFC is considered to be predominantly engaged in the active conduct of a banking, financing, or similar business if (1) more than 70 percent of its gross income is derived from transactions with unrelated persons and more than 20 percent of its gross income from that business is derived from transactions with unrelated persons located within the country in which the CFC is organized or incorporated, or (2) the CFC is predominantly engaged in the active conduct of a banking or securities business, or is a qualified bank or securities affiliate, as defined for purposes of the passive foreign investment company provisions.

Under the bill, foreign personal holding company income also does not include certain investment income of a qualifying insurance company with respect to risks located within the CFC's country of organization. These exceptions apply to income derived from investments of assets equal to the total of (1) unearned premiums and reserves ordinary and necessary for the proper conduct of the CFC's insurance business, (2) one-third of premiums earned during the taxable year on insurance contracts regulated in the country in which sold as property, casualty, or health insurance contracts, and (3) the greater of $10 million or 10 percent of reserves for insurance contracts regulated in the country in which sold as life insurance or annuity contracts. For this purpose, a qualifying insurance company is an entity that is subject to regulation as an insurance company under the laws of its country of incorporation and that realizes at least 50 percent of its gross income (other than income from investments) from premiums related to risks located within such country. The bill's exceptions for insurance investment income do not apply to investment income which is received by the CFC from a related person. Similarly, the exceptions do not apply to investment income that is attributable directly or indirectly to the insurance or reinsurance of risks of related persons. The bill does not change the rule of present law that investment income of a CFC that is attributable to the issuing or reinsuring any insurance or annuity contract related to risks outside of its country of organization is taxable as Subpart F insurance income.

The bill also provides an exception from foreign base company services income for income derived from services performed in connection with the active conduct of a banking, financing, insurance or similar business by a CFC that is predominantly engaged in the active conduct of such business.

Effective date.—The provision applies only to taxable years of foreign corporations beginning in 1998, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

Conference Committee Report

The conference agreement generally follows the Senate amendment with modifications.

Under the conference agreement, the temporary exception from foreign personal holding company income applies to income that is derived in the active conduct of a banking, financing or similar business by a CFC that is predominantly engaged in the active conduct of such business. For this purpose, income derived in the active conduct of a banking, financing, or similar business generally is determined under the principles applicable in determining financial services income for foreign tax credit limitation purposes. However, in the case of a corporation that is engaged in the active conduct of a banking or securities business, the income that is eligible for this exception is determined under the principles applicable in determining the income which is treated as nonpassive income for purposes of the passive foreign investment company provisions. The conferees generally intend that the income of a corporation engaged in the active conduct of a banking or securities business that is eligible for this exception is the income that is treated as nonpassive under the regulations proposed under section 1296(b). See Prop. Treas. Reg. secs. 1.1296-4 and 1.1296-6. In this regard, the conferees intend that eligible income will include income or gains with respect to foreclosed property which is incident to the active conduct of a banking business.

For purposes of the temporary exception, a corporation is considered to be predominantly engaged in the active conduct of a banking, financing, or similar business if it is engaged in the active conduct of a banking or securities business or is a qualified bank affiliate or qualified securities affiliate. In this regard, the conferees intend that a corporation will be considered to be engaged in the active conduct of a banking or securities business if the corporation would be treated as so engaged under the regulations proposed under section 1296(b); the conferees further intend that qualified bank affiliates and qualified securities affiliates will be as determined under such proposed regulations. See Prop. Treas. Reg. secs. 1.1296-4 and 1.1296-6.

Alternatively, a corporation is considered to be engaged in the active conduct of a banking, financing or similar business if more than 70 percent of its gross income is derived from such business from transactions with unrelated persons located within the country under the laws of which the corporation is created or organized. For this purpose, income derived by a qualified business unit of a corporation from transactions with unrelated persons located in the country in which the qualified business unit maintains its principal office and conducts substantial business activity is treated as derived by the corporation from transactions with unrelated persons located within the country in which the corporation is created or organized. A person other than a natural person is considered to be located within the country in which it maintains an office through which it engages in a trade or business and by which the transaction is effected. A natural person is treated as located within the country in which such person is physically located when such person enters into the transaction.

The conference agreement provides a temporary exception from foreign personal holding company income for certain investment income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization. The rules of this provision of the conference agreement differ from the rules of present-law section 953 of the Code, which determines the subpart F inclusions of a U.S. shareholder relating to insurance income of a CFC. Such insurance income under section 953 generally is computed in accordance with the rules of subchapter L of the Code. The conferees believe that review of the rules of this provision would be appropriate when final guidance under section 953 is published by the Treasury Department.

The conference agreement provides a temporary exception for income (received from a person other than a related person) from investments made by a qualifying insurance company of its reserves or 80 percent of its unearned premiums (as defined for purposes of the provision). For this purpose, in the case of contracts regulated in the country in which sold as property, casualty, or health insurance contracts, unearned premiums and reserves mean unearned premiums and reserves for losses incurred determined using the methods and interest rates that would be used if the qualifying insurance company were subject to tax under subchapter L of the Code. Thus, for this purpose, unearned premiums are determined in accordance with section 832(b)(4), and reserves for losses incurred are determined in accordance with section 832(b)(5) and 846 of the Code (as well as any other rules applicable to a U.S. property and casualty insurance company with respect to such amounts).

In the case of a contract regulated in the country in which sold as a life insurance or annuity contract, the following three alternative rules for determining reserves are provided under the con-

ference agreement. It is intended that any one of the three rules may be elected with respect to a particular line of business.

First, reserves for such contracts may be determined generally under the rules applicable to domestic life insurance companies under subchapter L of the Code, using the methods there specified, but substituting for the interest rates in Code section 807(d)(2)(B) an interest rate determined for the country in which the qualifying insurance company was created or organized, calculated in the same manner as the mid-term applicable Federal interest rate ("AFR") (within the meaning of section 1274(d)).

Second, the reserves for such contracts may be determined generally using a preliminary term foreign reserve method, except that the interest rate to be used is the interest rate determined for the country in which the qualifying insurance company was created or organized, calculated in the same manner as the mid-term AFR. If a qualifying insurance company uses such a preliminary term method with respect to contracts insuring risks located in the country in which the company is created or organized, then such method is the method that applies for purposes of this election.

Third, reserves for such contracts may be determined to be equal to the net surrender value of the contract (as defined in section 807(e)(1)(A)).

In no event may the reserve for any contract at any time exceed the foreign statement reserve for the contract, reduced by any catastrophe or deficiency reserve. This rule applies whether the contract is regulated as a property, casualty, health, life insurance, annuity, or any other type of contract.

The conference agreement also provides a temporary exception for income from investment of assets equal to (1) one-third of premiums earned during the taxable year on insurance contracts regulated in the country in which sold as property, casualty, or health insurance contacts, and (2) the greater of 10 percent of reserves, or, in the case of a qualifying insurance company that is a startup company, $10 million. For this purpose, a startup company is a company (including any predecessor) that has not been engaged in the active conduct of an insurance business for more than 5 years. It is intended that the 5-year period commences when the foreign company first is engaged in the active conduct of an insurance business. If the foreign company was formed before being acquired by the U.S. shareholder, the 5-year period commences when the acquired company first was engaged in the active conduct of an insurance business. The conferees intend that in the event of the acquisition of a book of business from another company through an assumption or indemnity reinsurance transaction, the period commences when the acquiring company first engaged in the active conduct of an insurance business, except that if more than a substantial part (e.g., 80 percent) of the business of the ceding company is acquired, then the 5-year period commences when the ceding company first engaged in the active conduct of an insurance business. In addition, it is not intended that reinsurance transactions among related persons be used to multiply the number of 5-year periods.

To prevent the shifting of relatively high-yielding assets to generate investment income that qualifies under this temporary exception, the conference agreement provides that, under rules prescribed by the Secretary, income is allocated to contracts as follows. In the case of contracts that are separate-account-type contracts (including variable contracts not meeting the requirements of section 817), only the income specifically allocable to such contracts is taken into account. In the case of other contracts, income not specifically allocable is allocated ratably among such contracts.

The conference agreement modifies the definition of a qualifying insurance company. Under the conference agreement, a qualifying insurance company means any entity which: (1) is regulated as an insurance company under the laws of the country in which it is incorporated; (2) derives at least 50 percent of its net written premiums from the insurance or reinsurance of risks situated within its country of incorporation; and (3) is engaged in the active conduct of an insurance business and would be subject to tax under subchapter L if it were a domestic corporation.

The conference agreement clarifies that this provision does not apply to investment income (includable in the income of a U.S. shareholder of a CFC pursuant to section 953) allocable to contracts that insure related party risks or risks located in a country other than the country in which the qualifying insurance company is created or organized.

Finally, the conference agreement provides an anti-abuse rule applicable for purposes of these temporary exceptions from foreign personal holding company income. For purposes of applying these exceptions, items with respect to a transaction or series of transactions shall be disregarded if one of the principal purposes of the transaction or transactions is to qualify income or gain for these exceptions, including any change in the method of computing reserves or any other transaction or transactions one of the principal purposes of which is the acceleration or deferral of any item in order to claim the benefits of these exceptions.

The conferees recognize that insurance, banking, financing, and similar businesses are businesses the active conduct of which involves the generation of income, such as interest and dividends, of a type that generally is treated as pas-

sive for purposes of subpart F. For purposes of this temporary provision, the conferees intend to delineate the income derived in the active conduct of such businesses, while retaining the present-law anti-deferral rules of subpart F with respect to income not derived in the active conduct of these financial services businesses. However, the conferees recognize that the line between income derived in the active conduct of such businesses and income otherwise derived by entities so engaged can be difficult to draw. The conferees believe that the issues of the determination of income derived in the active conduct of such businesses and the potential mobility of the business activity and income recognition of insurance, banking, financing, and similar businesses require further study. In the event that it becomes necessary to consider a possible extension of the provision in the future, the conferees would invite the comments of taxpayers and the Treasury Department regarding these issues.

[¶ 12,115] Act Sec. 1201(a) and (c). Law at ¶ 5039. CCH Explanation at ¶ 101.

Simplification Provisions—Individuals

House Committee Report

[*Standard deduction of dependents*]

Modifications to standard deduction of dependents; AMT treatment of certain minor children.—

*Standard deduction of dependents.—*The bill increases the standard deduction for a taxpayer with respect to whom a dependency exemption is allowed on another taxpayer's return to the lesser of (1) the standard deduction for individual taxpayers or (2) the greater of: (a) $500[134] (indexed for inflation as under present law), or (b) the individual's earned income plus $250. The $250 amount is indexed for inflation after 1998.

* * *

*Effective date.—*The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

*Senate Amendment.—*The Senate amendment is the same as the House bill.

*Conference Agreement.—*The conference agreement follows the House bill and the Senate amendment.

[¶ 12,120] Act Sec. 1201(b) and (c). Law at ¶ 5035 and 5613. CCH Explanation at ¶ 185.

Simplification Provisions—Individuals

House Committee Report

[*AMT exemption for minor children*]

Modifications to standard deduction of dependents; AMT treatment of certain minor children.—

* * *

*Alternative minimum tax exemption for children under age 14.—*The bill increases the AMT exemption amount for a child under age 14 to the lesser of (1) $33,750 or (2) the sum of the child's earned income plus $5,000. The $5,000 amount is indexed for inflation after 1998.

*Effective date.—*The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

*Senate Amendment.—*The Senate amendment is the same as the House bill.

*Conference Agreement.—*The conference agreement follows the House bill and the Senate amendment.

[¶ 12,125] Act Sec. 1202. Law at ¶ 5693. CCH Explanation at ¶ 1101.

Simplification Provisions—Individuals

House Committee Report

[*Estimated tax de minimis threshold*]

*Increase de minimis threshold for estimated tax to $1,000 for individuals.—*The bill increases the $500 individual estimated tax de minimis threshold to $1,000.

*Effective date.—*The provision is effective for taxable years beginning after December 31, 1997.

[134] Projected to be $700 for 1998.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,130] Act Sec. 1203. Law at ¶ 5067 and 7043. CCH Explanation at ¶ 113.

Simplification Provisions—Individuals

House Committee Report (Code and Related Non-Code Provisions)

[*Rural letter carrier vehicle expenses*]

Treatment of certain reimbursed expenses of rural letter carriers' vehicles.—The bill repeals the special rate for Postal Service employees of 150 percent of the standard mileage rate. In its place, the bill requires that the rate of reimbursement provided by the Postal Service to rural letter carriers be considered to be equivalent to their expenses. The rate of reimbursement that is considered to be equivalent to their expenses is the rate of reimbursement contained in the 1991 collective bargaining agreement, which may be increased by no more than the rate of inflation.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,135] Act Sec. 1204. Law at ¶ 5067. CCH Explanation at ¶ 115.

Simplification Provisions—Individuals

House Committee Report

[*Federal employee travel expenses: Criminal investigations*]

Travel expenses of Federal employees participating in a federal criminal investigation.—The one-year limitation with respect to deductibility of expenses while temporarily away from home does not include any period during which a Federal employee is certified by the Attorney General (or the Attorney General's designee) as traveling on behalf of the Federal Government in a temporary duty status to investigate or provide support services to the investigation of a Federal crime. Thus, expenses for these individuals during these periods are fully deductible, regardless of the length of the period for which certification is given (provided that the other requirements for deductibility are satisfied).

Effective date.—The provision is effective for amounts paid or incurred with respect to taxable years ending after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,140] Act Sec. 1205. Law at ¶ 5613, 5661 and 5719. CCH Explanation at ¶ 1111.

Simplification Provisions—Individuals

House Committee Report

[*Tax payments by commercially acceptable means*]

Payment of taxes by commercially acceptable means.—

In general.—The Internal Revenue Service (IRS) is engaged in a long-term modernization of its information systems, the Tax Systems Modernization (TSM) Program. This modernization is intended to address deficiencies in the current IRS information systems and to plan effectively for future information system needs and requirements. The systems changes are designed to reduce the burden on taxpayers, generate additional revenue through improved voluntary compliance, and achieve productivity gains throughout the IRS. One key element of this program is electronic filing of tax returns.

At the present time, increasing reliance is being placed upon electronic funds transfers for payment of obligations. In light of this, the IRS seeks

to integrate these payment methods in its TSM program, including electronic filing of returns, as well as into its traditional collection functions. The bill allows the IRS to accept payment by any commercially acceptable means that the Secretary deems appropriate, to the extent and under the conditions provided in Treasury regulations. This will include, for example, electronic funds transfers, including those arising from credit cards, debit cards, and charge cards.

The IRS contemplates that it will proceed to negotiate contracts to implement this provision with one or more private sector credit and debit card systems. The bill provides that the Federal Government may pay fees with respect to any such contracts only out of amounts specifically appropriated for that purpose.

Billing error resolution.—In the course of processing these transactions, it will be necessary to resolve billing errors and other disputes. The Internal Revenue Code contains mechanisms for the determination of tax liability, defenses and other taxpayer protections, and the resolution of disputes with respect to those liabilities. The Truth-in-Lending Act contains provisions for determination of credit card liabilities, defenses and other consumer protections, and the resolution of disputes with respect to these liabilities.

The bill excludes credit card, debit card, and charge card issuers and processing mechanisms from the resolution of tax liability, but makes IRS subject to the Truth-in-Lending provisions insofar as those provisions impose obligations and responsibilities with regard to the "billing error" resolution process. It is not intended that consumers obtain additional ways to dispute their tax liabilities under the Truth-in-Lending provisions.

The bill also specifically includes the use of debit cards in this provision and provides that the corresponding defenses and "billing error" provisions of the Electronic Fund Transfer Act will apply in a similar manner.

The bill adds new section 6311(d)(3) to the Code. This section describes the circumstances under which section 161 of the Truth-in-Lending Act ("TILA") and section 908 of the Electronic Fund Transfer Act ("EFTA") apply to disputes that may arise in connection with payments of taxes made by credit card or debit card. Subsections (A) through (C) recognize that "billing errors" relating to the credit card account, such as an error arising from a credit card transaction posted to a cardholder's account without the cardholder's authorization, an amount posted to the wrong cardholder's account, or an incorrect amount posted to a cardholder's account as a result of a computational error or numerical transposition, are governed by the billing error provisions of section 161 of TILA. Similarly, subsections 6311(d)(3)(A)-(C) provide that errors such as those described above which arise in connection with payments of internal revenue taxes made by debit card, are governed by section 908 of EFTA.

The Internal Revenue Code provides that refunds are only authorized to be paid to the person who made the overpayment (generally the taxpayer). Subsection 6311(d)(3)(E), however, provides that where a taxpayer is entitled to receive funds as a result of the correction of a billing error made under section 161 of TILA in connection with a credit card transaction, or under section 908 of EFTA in connection with a debit card transaction, the IRS is authorized to utilize the appropriate credit card or debit card system to initiate a credit to the taxpayer's credit card or debit card account. The IRS may, therefore, provide such funds through the taxpayer's credit card or debit card account rather than directly to the taxpayer.

On the other hand, subsections 6311(d)(3)(A)-(C) provide that any alleged error or dispute asserted by a taxpayer concerning the merits of the taxpayer's underlying tax liability or tax return is governed solely by existing tax laws, and is not subject to section 161 or section 170 of TILA, section 908 of EFTA, or any similar provisions of State law. Absent the exclusion from section 170 of TILA, in a collection action brought against the cardholder by the card issuer the cardholder might otherwise assert as a defense that the IRS had incorrectly computed his tax liability. A collection action initiated by a credit card issuer against the taxpayer/cardholder will be an inappropriate vehicle for the determination of a taxpayer's tax liability, especially since the United States will not be a party to such an action.

Similarly, without the exclusion from section 161 of TILA and section 908 of EFTA, a taxpayer could contest the merits of his tax liability by putting the charge which appears on the credit card bill in dispute. Pursuant to TILA or EFTA, the taxpayer's card issuer will have to investigate the dispute, thereby finding itself in the middle of a dispute between the IRS and the taxpayer. It is believed that it is improper to attempt to resolve tax disputes through the billing process. It is also noted that the taxpayer retains the traditional, existing remedies for resolving tax disputes, such as resolving the dispute administratively with the IRS, filing a petition with the Tax Court after receiving a statutory notice of deficiency, or paying the disputed tax and filing a claim for refund (and subsequently filing a refund suit if the claim is denied or not acted upon).

Creditor status.—The TILA imposes various responsibilities and obligations on creditors. Although the definition of the term "creditor" set forth in 15 U.S.C. sec. 1602 is limited, and will generally not include the IRS, in the case of an open-end credit plan involving a credit card, the card issuer and any person who honors the credit

card are, pursuant to 15 U.S.C. sec. 1602(f), creditors.

In addition, 12 CFR sec. 226.12(e) provides that the creditor must transmit a credit statement to the card issuer within 7 business days from accepting the return or forgiving the debt. There is a concern that the response deadlines otherwise imposed by 12 CFR sec. 226.12(e), if applicable, will be difficult for the IRS to comply with (given the volume of payments the IRS is likely to receive in peak periods). This could subject the IRS to unwarranted damage actions. Consequently, the bill generally provides an exception to creditor status for the IRS.

Privacy protections.—The bill also addresses privacy questions that arise from the IRS' participation in credit card processing systems. It is believed that taxpayers expect that the maximum possible protection of privacy will be accorded any transactions they have with the IRS. Accordingly, the bill provides the greatest possible protection of taxpayers' privacy that is consistent with developing and operating an efficient tax administration system. It is expected that the principle will be fully observed in the implementation of this provision.

A key privacy issue is the use and redisclosure of tax information by financial institutions for purposes unrelated to the processing of credit card charges, i.e., marketing and related uses. To accept credit card charges by taxpayers, the IRS will have to disclose tax information to financial institutions to obtain payment and to resolve billing disputes. To obtain payment, the IRS will have to disclose, at a minimum, information on the "credit slip," i.e., the dollar amount of the payment and the taxpayer's credit card number.

The resolution of billing disputes may require the disclosure of additional tax information to financial institutions. In most cases, providing a copy of the credit slip and verifying the transaction amount will be sufficient. Conceivably, financial institutions could require some information regarding the underlying liability even where the dispute concerns a "billing dispute" matter. This additional information will not necessarily be shared as widely as the initial payment data. In lieu of disclosing further information, the IRS may elect to allow disputed amounts to be charged back to the IRS and to reinstate the corresponding tax liability.

Despite the language in most cardholder agreements that permits redisclosure of credit card transaction information, the public may be largely unaware of how widely that information is shared. For example, some financial institutions may share credit, payment, and purchase information with private credit bureaus, who, in turn, may sell this information to direct mail marketers, and others. Without use and redisclosure restrictions, taxpayers may discover that some traditionally confidential tax information might be widely disseminated to direct mail marketers and others.

It is intended that credit or debit card transaction information will generally be restricted to those uses necessary to process payments and resolve billing errors, as well as other purposes that are specified in the statute. The bill directs the Secretary to issue published procedures on what constitutes authorized uses and disclosures. It is anticipated that the Secretary's published procedures will prohibit the use of transaction information for marketing tax-related services by the issuer or any marketing that targets only those who use their credit card to pay their taxes. It is also anticipated that the published procedures will prohibit the sale of transaction information to a third party.

Effective date.—The provision is effective nine months after the date of enactment. The IRS may, in this interim period, conduct internal tests and negotiate with card issuers, but may not accept credit or debit cards for payment of tax liability.

Conference Committee Report

The conference agreement follows the House bill, except that the requirement that a separate appropriation be made for payment by the IRS of credit card fees is deleted, and a prohibition on the payment by the IRS of any fee or the provision of any other consideration is added.

[¶ 12,165] Act Sec. 1211. Law at ¶ 5163. CCH Explanation at ¶ 338.

Simplification Provisions—Businesses

House Committee Report

[*Look-back method for long-term contracts*]

Modifications to look-back method for long-term contracts.—

Election not to apply the look-back method for de minimis amounts.—The provision provides that a taxpayer may elect not to apply the look-back method with respect to a long-term contract if for each prior contract year, the cumulative taxable income (or loss) under the contract as determined using estimated contract price and costs is within 10 percent of the cumulative taxable income (or loss) as determined using actual contract price and costs.

Thus, under the election, upon completion of a long-term contract, a taxpayer would be required to apply the first step of the look-back method (the reallocation of gross income using actual, rather than estimated, contract price and costs), but is not required to apply the additional steps of the look-back method if the application of the first step resulted in de minimis changes to the amount of income previously taken into account for each prior contract year.

The election applies to all long-term contracts completed during the taxable year for which the election is made and to all long-term contracts completed during subsequent taxable years, unless the election is revoked with the consent of the Secretary of the Treasury.

Example 1.—A taxpayer enters into a three-year contract and upon completion of the contract, determines that annual net income under the contract using actual contract price and costs is $100,000, $150,000, and $250,000, respectively, for Years 1, 2, and 3 under the percentage of completion method. An electing taxpayer need not apply the look-back method to the contract if it had reported cumulative net taxable income under the contract using estimated contract price and costs of between $90,000 and $110,000 as of the end of Year 1; and between $225,000 and $275,000 as of the end of Year 2.

Election not to reapply the look-back method.—The provision provides that a taxpayer may elect not to reapply the look-back method with respect to a contract if, as of the close of any taxable year after the year the contract is completed, the cumulative taxable income (or loss) under the contract is within 10 percent of the cumulative look-back income (or loss) as of the close of the most recent year in which the look-back method was applied (or would have applied but for the other de minimis exception described above). In applying this rule, amounts that are taken into account after completion of the contract are not discounted.

Thus, an electing taxpayer need not apply or reapply the look-back method if amounts that are taken into account after the completion of the contract are de minimis.

The election applies to all long-term contracts completed during the taxable year for which the election is made and to all long-term contracts completed during subsequent taxable years, unless the election is revoked with the consent of the Secretary of the Treasury.

Example 2.—A taxpayer enters into a three-year contract and reports taxable income of $12,250, $15,000 and $12,750, respectively, for Years 1 through 3 with respect to the contract. Upon completion of the contract, cumulative look-back income with respect to the contract is $40,000, and 10 percent of such amount is $4,000. After the completion of the contract, the taxpayer incurs additional costs of $2,500 in each of the next three succeeding years (Years 4, 5, and 6) with respect to the contract. Under the provision, an electing taxpayer does not reapply the look-back method for Year 4 because the cumulative amount of contract taxable income ($37,500) is within 10 percent of contract look-back income as of the completion of the contract ($40,000). However, the look-back method must be applied for Year 5 because the cumulative amount of contract taxable income ($35,000) is not within 10 percent of contract look-back income as of the completion of the contract ($40,000). Finally, the taxpayer does not reapply the look-back method for Year 6 because the cumulative amount of contract taxable income ($32,500) is within 10 percent of contract look-back income as of the last application of the look-back method ($35,000).

Interest rates used for purposes of the look-back method.—The provision provides that for purposes of the look-back method, only one rate of interest is to apply for each accrual period. An accrual period with respect to a taxable year begins on the day after the return due date (determined without regard to extensions) for the taxable year and ends on such return due date for the following taxable year. The applicable rate of interest is the overpayment rate in effect for the calendar quarter in which the accrual period begins.

Effective date.—The provision applies to contracts completed in taxable years ending after the date of enactment. The change in the interest rate calculation also applies for purposes of the look-back method applicable to the income forecast method of depreciation for property placed in service after September 13, 1995.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,170] Act Sec. 1212. Law at ¶ 5031. CCH Explanation at ¶ 529.

Simplification Provisions—Businesses

House Committee Report

[*Property and casualty insurance companies*]

Minimum tax treatment of certain property and casualty insurance companies.—The bill provides that a property and casualty insurance company that elects for regular tax purposes to be taxed only on taxable investment income determines its adjusted current earnings under the alternative minimum tax without regard to any amount not taken into account in determining its gross investment income under section 834(b). Thus, adjusted current earnings of an electing company is determined without regard to underwriting income (or underwriting expense, as provided in sec. 56(g)(4)(B)(I)(II)).

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,175] Act Sec. 1213. Law at ¶ 5047, 5075 and 5711. CCH Explanation at ¶ 322.

Other Miscellaneous Provisions

House Committee Report

[*Lessee construction allowances*]

Treatment of construction allowances provided to lessees.—The bill provides that the gross income of a lessee does not include amounts received in cash (or treated as a rent reduction) from a lessor under a short-term lease of retail space for the purpose of the lessee's construction or improvement of qualified long-term real property for use in the lessee's trade or business at such retail space. The exclusion only applies to the extent the allowance does not exceed the amount expended by the lessee on the construction or improvement of qualified long-term real property. For this purpose, "qualified long-term real property" means nonresidential real property that is part of, or otherwise present at, retail space used by the lessee and that reverts to the lessor at the termination of the lease. A "short-term lease" means a lease or other agreement for the occupancy or use of retail space for a term of 15 years or less (as determined pursuant to sec. 168(i)(3)). "Retail space" means real property leased, occupied, or otherwise used by the lessee in its trade or business of selling tangible personal property or services to the general public.

The bill provides that lessor will treat the amounts expended on the construction allowance as nonresidential real property. However, the lessee's exclusion is not dependent upon the lessor's treatment of the property as nonresidential real property.

The bill contains reporting requirements to ensure that both the lessor and lessee treat such amounts as nonresidential real property. Under regulations. the lessor and the lessee, shall, at such times and in such manner as provided by the regulations, furnish to the Secretary of the Treasury information concerning the amounts received (or treated as a rent reduction), the amounts expended on qualified long-term real property, and such other information as the Secretary deems necessary to carry out the provisions of the bill. It is expected that the Secretary, in promulgating such regulations, will attempt to minimize the administrative burdens of taxpayers while ensuring compliance with the bill.

Effective date.—The provision applies to leases entered into after the date of enactment. No inference is intended as to the treatment of amounts that are not subject to the provision.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement generally follows the House bill and the Senate amendment, with a clarification of the coordination of the provision and present-law rule that allows lessors to take losses with respect to certain leasehold improvements abandoned at the end of the term of the lease (sec. 168(i)(8)). In addition, the conferees wish to emphasize that no inference is intended as to the treatment of amounts that are not subject to the provision, and that the provisions of the IRS issue paper and present law (including case law) will continue to apply where applicable.

[¶ 12,215] Act Sec. 1221. Law at ¶ 5233, 5235, 5237, 5239, 5241 and 5245. CCH Explanation at ¶ 412, 413, 414, 415, 416, 417, 418 and 420.

Partnership Simplification Provisions—General

House Committee Report

[*Flow-through for electing large partnerships*]

Simplified flow-through for electing large partnerships.—

In general.—The bill modifies the tax treatment of an electing large partnership (generally, any partnership that elects under the provision, if the number of partners in the preceding taxable year is 100 or more) and its partners. The provision provides that each partner takes into account separately the partner's distributive share of the following items, which are determined at the partnership level: (1) taxable income or loss from passive loss limitation activities; (2) taxable income or loss from other activities (e.g., portfolio income or loss); (3) net capital gain or loss to the extent allocable to passive loss limitation activities and other activities; (4) tax-exempt interest; (5) net alternative minimum tax adjustment separately computed for passive loss limitation activities and other activities; (6) general credits; (7) low-income housing credit; (8) rehabilitation credit; (9) credit for producing fuel from a nonconventional source; (10) creditable foreign taxes and foreign source items; and (11) any other items to the extent that the Secretary determines that separate treatment of such items is appropriate.[137] Separate treatment may be appropriate, for example, should changes in the law necessitate such treatment for any items.

Under the bill, the taxable income of an electing large partnership is computed in the same manner as that of an individual, except that the items described above are separately stated and certain modifications are made. These modifications include disallowing the deduction for personal exemptions, the net operating loss deduction and certain itemized deductions.[138] All limitations and other provisions affecting the computation of taxable income or any credit (except for the at risk, passive loss and itemized deduction limitations, and any other provision specified in regulations) are applied at the partnership (and not the partner) level.

All elections affecting the computation of taxable income or any credit generally are made by the partnership.

Capital gains.—Under the bill, netting of capital gains and losses occurs at the partnership level. A partner in a large partnership takes into account separately his distributive share of the partnership's net capital gain or net capital loss.[139] Such net capital gain or loss is treated as long-term capital gain or loss.

Any excess of net short-term capital gain over net long-term capital loss is consolidated with the partnership's other taxable income and is not separately reported.

A partner's distributive share of the partnership's net capital gain is allocated between passive loss limitation activities and other activities. The net capital gain is allocated to passive loss limitation activities to the extent of net capital gain from sales and exchanges of property used in connection with such activities, and any excess is allocated to other activities. A similar rule applies for purposes of allocating any net capital loss.

Any gains and losses of the partnership under section 1231 are netted at the partnership level. Net gain is treated as long-term capital gain and is subject to the rules described above. Net loss is treated as ordinary loss and consolidated with the partnership's other taxable income.

Deductions.—The bill contains two special rules for deductions. First, miscellaneous itemized deductions are not separately reported to partners. Instead, 70 percent of the amount of such deductions is disallowed at the partnership level;[140] the remaining 30 percent is allowed at the partnership level in determining taxable income, and is not subject to the two-percent floor at the partner level.

Second, charitable contributions are not separately reported to partners under the bill. Instead, the charitable contribution deduction is allowed at the partnership level in determining taxable income, subject to the limitations that apply to corporate donors.

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[137] In determining the amounts required to be separately taken into account by a partner, those provisions of the large partnership rules governing computations of taxable income are applied separately with respect to that partner by taking into account that partner's distributive share of the partnership's items of income, gain, loss, deduction or credit. This rule permits partnerships to make otherwise valid special allocations of partnership items to partners.

[138] An electing large partnership is allowed a deduction under section 212 for expenses incurred for the production of income, subject to 70-percent disallowance. No income from an electing large partnership is treated as fishing or farming income.

[139] The term "net capital gain" has the same meaning as in section 1222(11). The term "net capital loss" means the excess of the losses from sales or exchanges of capital assets over the gains from sales or exchanges of capital assets. Thus, the partnership cannot offset any portion of capital losses against ordinary income.

[140] The 70 percent figure is intended to approximate the amount of such deductions that would be denied at the partner level as a result of the two-percent floor.

Credits in general.—Under the bill, general credits are separately reported to partners as a single item. General credits are any credits other than the low-income housing credit, the rehabilitation credit and the credit for producing fuel from a nonconventional source. A partner's distributive share of general credits is taken into account as a current year general business credit. Thus, for example, the credit for clinical testing expenses is subject to the present law limitations on the general business credit. The refundable credit for gasoline used for exempt purposes and the refund or credit for undistributed capital gains of a regulated investment company are allowed to the partnership, and thus are not separately reported to partners.

In recognition of their special treatment under the passive loss rules, the low-income housing and rehabilitation credits are separately reported.[141] In addition, the credit for producing fuel from a nonconventional source is separately reported.

The bill imposes credit recapture at the partnership level and determines the amount of recapture by assuming that the credit fully reduced taxes. Such recapture is applied first to reduce the partnership's current year credit, if any; the partnership is liable for any excess over that amount. Under the bill, the transfer of an interest in an electing large partnership does not trigger recapture.

Foreign taxes.—The bill retains present-law treatment of foreign taxes. The partnership reports to the partner creditable foreign taxes and the source of any income, gain, loss or deduction taken into account by the partnership. Elections, computations and limitations are made by the partner.

Tax-exempt interest.—The bill retains present-law treatment of tax-exempt interest. Interest on a State or local bond is separately reported to each partner.

Unrelated business taxable income.—The bill retains present-law treatment of unrelated business taxable income. Thus, a tax-exempt partner's distributive share of partnership items is taken into account separately to the extent necessary to comply with the rules governing such income.

Passive losses.—Under the bill, a partner in an electing large partnership takes in an electing to account separately his distributive share of the partnership's taxable income or loss from passive loss limitation activities. The term "passive loss limitation activity" means any activity involving the conduct of a trade or business (including any activity treated as a trade or business under sec. 469(c)(5) or (6)) and any rental activity. A partner's share of an electing large partnership's taxable income or loss from passive loss limitation activities is treated as an item of income or loss from the conduct of a trade or business which is a single passive activity, as defined in the passive loss rules. Thus, an electing large partnership generally is not required to separately report items from multiple activities.

A partner in an electing large partnership also takes into account separately his distributive share of the partnership's taxable income or loss from activities other than passive loss limitation activities. Such distributive share is treated as an item of income or expense with respect to property held for investment. Thus, portfolio income (e.g., interest and dividends) is reported separately and is reduced by portfolio deductions and allocable investment interest expense.

In the case of a partner holding an interest in an electing large partnership which is not a limited partnership interest, such partner's distributive share of any items are taken into account separately to the extent necessary to comply with the passive loss rules. Thus, for example, income of an electing large partnership is not treated as passive income with respect to the general partnership interest of a partner who materially participates in the partnership's trade or business.

Under the bill, the requirement that the passive loss rule be separately applied to each publicly traded partnership (sec. 469(k) of the Code) continues to apply.

Alternative minimum tax.—Under the bill, alternative minimum tax ("AMT") adjustments and preferences are combined at the partnership level. An electing large partnership would report to partners a net AMT adjustment separately computed for passive loss limitation activities and other activities. In determining a partner's alternative minimum taxable income, a partner's distributive share of any net AMT adjustment is taken into account instead of making separate AMT adjustments with respect to partnership items. The net AMT adjustment is determined by using the adjustments applicable to individuals (in the case of partners other than corporations), and by using the adjustments applicable to corporations (in the case of corporate partners). Except as provided in regulations, the net AMT adjustment is treated as a deferral preference for purposes of the section 53 minimum tax credit.

Discharge of indebtedness income.—If an electing large partnership has income from the discharge of any indebtedness, such income is separately reported to each partner. In addition, the rules governing such income (sec. 108) are applied without regard to the large partnership rules. Partner-level elections under section 108

[141] It is understood that the rehabilitation and low-income housing credits which are subject to the same passive loss rules (i.e., in the case of the low-income housing credit, where the partnership interest was acquired or the property was placed in service before 1990) could be reported together on the same line.

are made by each partner separately. Thus, for example, the large partnership provisions do not affect section 108(d)(6), which provides that certain section 108 rules apply at the partner level, or section 108(b)(5), which provides for an election to reduce the basis of depreciable property. The large partnership provisions also do not affect the election under 108(c) (added by the Omnibus Budget Reconciliation Act of 1993) to exclude discharge of indebtedness income with respect to qualified real property business indebtedness.

REMICs.—For purposes of the tax on partnerships holding residual interests in REMICs, all interests in an electing large partnership are treated as held by disqualified organizations. Thus, an electing large partnership holding a residual interest in a REMIC is subject to a tax equal to the excess inclusions multiplied by the highest corporate rate. The amount subject to tax is excluded from partnership income.

Election of optional basis adjustments.—Under the bill, an electing large partnership may still elect to adjust the basis of partnership assets with respect to transferee partners. The computation of an electing large partnership's taxable income is made without regard to the section 743(b) adjustment. As under present law, the section 743(b) adjustment is made only with respect to the transferee partner. In addition, an electing large partnership is permitted to adjust the basis of partnership property under section 734(b) if property is distributed to a partner, as under present law.

Terminations.—The bill provides that an electing large partnership does not terminate for tax purposes solely because 50 percent of its interests are sold or exchanged within a 12-month period.

Partnerships and partners subject to large partnership rules.—

Definition of electing large partnership.—An "electing large partnership" is any partnership that elects under the provision, if the number of partners in the preceding taxable year is 100 or more. The number of partners is determined by counting only persons directly holding partnership interests in the taxable year, including persons holding through nominees; persons holding indirectly (e.g., through another partnership) are not counted. Regulations may provide, however, that if the number of partners in any taxable year falls below 100, the partnership may not be treated as an electing large partnership. The election applies to the year for which made and all subsequent years and cannot be revoked without the Secretary's consent.

Special rules for certain service partnerships.—An election under this provision is not effective for any partnership if substantially all the partners are: (1) individuals performing substantial services in connection with the partnership's activities, or personal service corporations the owner-employees of which perform such services; (2) retired partners who had performed such services; or (3) spouses of partners who had performed such services. In addition, the term "partner" does not include any individual performing substantial services in connection with the partnership's activities and holding a partnership interest, or an individual who formerly performed such services and who held a partnership interest at the time the individual performed such services.

Exclusion for commodity partnerships.—An election under this provision is not effective for any partnership the principal activity of which is the buying and selling of commodities (not described in sec. 1221(1)), or options, futures or forwards with respect to commodities.

Special rules for partnerships holding oil and gas properties.—

Simplified reporting treatment of electing large partnerships with oil and gas activities.—The bill provides special rules for electing large partnerships with oil and gas activities that operate under the simplified reporting regime. These partnerships are collectively referred to herein as "oil and gas large partnerships." Generally, the bill provides that an oil and gas large partnership reports information to its partners under the general simplified large partnership reporting regime described above. To prevent the extension of percentage depletion deductions to persons excluded therefrom under present law, however, certain partners are treated as disqualified persons under the bill.

The treatment of a disqualified person's distributive share of any item of income, gain, loss, deduction, or credit attributable to any partnership oil or gas property is determined under the bill without regard to the special rules applicable to large partnerships. Thus, an oil and gas large partnership reports information related to oil and gas activities to a partner who is a disqualified person in the same manner and to the same extent that it reports such information to that partner under present law. The simplified reporting rules of the bill, however, apply with respect to reporting such a partner's share of items not related to oil and gas activities.

The bill defines two categories of taxpayers as disqualified persons. The first category encompasses taxpayers who do not qualify for the deduction for percentage depletion under section 613A (i.e., integrated producers of oil and gas). The second category includes any person whose average daily production of oil and gas (for purposes of determining the depletable oil and natural gas quantity under section 613A(c)(2)) is at least 500 barrels for its taxable year in which (or with which) the partnership's taxable year ends. In making this computation, all production of domestic crude oil and natural gas attributable to

the partner is taken into account, including such partner's proportionate share of any production of the large partnership.

A taxpayer that falls within a category of disqualified person has the responsibility of notifying any large partnership in which it holds a direct or indirect interest (e.g., through a pass-through entity) of its status as such. Thus, for example, if an integrated producer owns an interest in a partnership which in turn owns an interest in an oil and gas large partnership, it is responsible for providing the management of the electing large partnership information regarding its status as a disqualified person and details regarding its indirect interest in the electing large partnership.

Under the bill, an oil and gas large partnership computes its deduction for oil and gas depletion under the general statutory rules (subject to certain exceptions described below) under the assumptions that the partnership is the taxpayer and that it qualifies for the percentage depletion deduction. The amount of the depletion deduction, as well as other oil and gas related items, generally are reported to each partner (other than to partners who are disqualified persons) as components of that partner's distributive share of taxable income or loss from passive loss limitation activities. The bill provides that in computing the partnership's oil and gas percentage depletion deduction, the 1,000-barrel-per-day limitation does not apply. In addition, an oil and gas large partnership is allowed to compute percentage depletion under the bill without applying the 65-percent-of-taxable-income limitation under section 613A(d)(1).

As under present law, an election to deduct IDCs under section 263(c) is made at the partnership level. Since the bill treats those taxpayers required by the Code (sec. 291) to capitalize 30 percent of IDCs as disqualified persons, an oil and gas large partnership may pass through a full deduction of IDCs to its partners who are not disqualified persons. In contrast to present law, an oil and gas large partnership also has the responsibility with respect to its partners who are not disqualified persons for making an election under section 59(e) to capitalize and amortize certain specified IDCs. Partners who are disqualified persons are permitted to make their own separate section 59(e) elections under the bill.

Consistent with the general reporting regime for electing large partnerships, the bill provides that a single AMT adjustment (under either corporate or non-corporate principles, as the case may be) is made and reported to the partners (other than disqualified persons) of an oil and gas large partnership as a separate item. This separately-reported item is affected by the limitation on the repeal of the tax preference for excess IDCs. For purposes of computing this limitation, the bill treats an oil and gas large partnership as the taxpayer. Thus, the limitation on repeal of the IDC preference is applied at the partnership level and is based on the cumulative reduction in the partnership's alternative minimum taxable income resulting from repeal of that preference.

The bill provides that in making partnership-level computations, any item of income, gain, loss, deduction, or credit attributable to a partner who is a disqualified person is disregarded. For example, in computing the partnership's net income from oil and gas for purposes of determining the IDC preference (if any) to be reported to partners who are not disqualified persons as part of the AMT adjustment, disqualified persons' distributive shares of the partnership's net income from oil and gas are not to be taken into account.

Regulatory authority.—The Secretary of the Treasury is granted authority to prescribe such regulations as may be appropriate to carry out the purposes of the provisions.

Effective date.—The provisions generally apply to partnership taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,245] Act Sec. 1222. Law at ¶ 5641, 5643, 5645, 5647, 5649, 5651, 5653, 5655, 5657, 5659, 5715, 5727, 5735 and 5737. CCH Explanation at ¶ 421, 422, 423, 424, 425, 426, 427 and 430.

Partnership Simplification Provisions—General

House Committee Report

[*Electing large partnership audit procedures*]

Simplified audit procedures for electing large partnerships.—The bill creates a new audit system for electing large partnerships. The provision defines "electing large partnership" the same way for audit and reporting purposes (generally, any partnership that elects under the reporting provisions, if the number of partners in the preceding taxable year is 100 or more).

As under present law, electing large partnerships and their partners are subject to unified audit rules. Thus, the tax treatment of "partnership items" are determined at the partnership, rather than the partner, level. The term "partnership items" is defined as under present law.

Unlike present law, however, partnership adjustments generally will flow through to the partners for the year in which the adjustment takes effect. Thus, the current-year partners' share of current-year partnership items of income, gains, losses, deductions, or credits will be adjusted to reflect partnership adjustments that take effect in that year. The adjustments generally will not affect prior-year returns of any partners (except in the case of changes to any partner's distributive shares).

In lieu of flowing an adjustment through to its partners, the partnership may elect to pay an imputed underpayment. The imputed underpayment generally is calculated by netting the adjustments to the income and loss items of the partnership and multiplying that amount by the highest tax rate (whether individual or corporate). A partner may not file a claim for credit or refund of his allocable share of the payment. A partnership may make this election only if it meets requirements set forth in Treasury regulations designed to ensure payment (for example, in the case of a foreign partnership).

Regardless of whether a partnership adjustment flows through to the partners, an adjustment must be offset if it requires another adjustment in a year after the adjusted year and before the year the offsetted adjustment takes effect. For example, if a partnership expensed a $1,000 item in year 1, and it was determined in year 4 that the item should have been capitalized and amortized ratably over 10 years, the adjustment in year 4 would be $700, apart from any interest or penalty. (The $900 adjustment for the improper deduction would be offset by $200 of adjustments for amortization deductions.) The year 4 partners would be required to include an additional $700 in income for that year. The partnership may ratably amortize the remaining $700 of expenses in years 4-10.

In addition, the partnership, rather than the partners individually, generally is liable for any interest and penalties that result from a partnership adjustment. Interest is computed for the period beginning on the return due date for the adjusted year and ending on the earlier of the return due date for the partnership taxable year in which the adjustment takes effect or the date the partnership pays the imputed underpayment. Thus, in the above example, the partnership would be liable for 4 years' worth of interest (on a declining principal amount).

Penalties (such as the accuracy and fraud penalties) are determined on a year-by-year basis (without offsets) based on an imputed underpayment. All accuracy penalty criteria and waiver criteria (such as reasonable cause, substantial authority, etc.) are determined as if the partnership were a taxable individual. Accuracy and fraud penalties are assessed and accrue interest in the same manner as if asserted against a taxable individual.

Any payment (for Federal income taxes, interest, or penalties) that an electing large partnership is required to make is non-deductible.

If a partnership ceases to exist before a partnership adjustment takes effect, the former partners are required to take the adjustment into account, as provided by regulations. Regulations are also authorized to prevent abuse and to enforce efficiently the audit rules in circumstances that present special enforcement considerations (such as partnership bankruptcy).

Administrative proceedings.—Under the electing large partnership audit rules, a partner is not permitted to report any partnership items inconsistently with the partnership return, even if the partner notifies the IRS of the inconsistency. The IRS may treat a partnership item that was reported inconsistently by a partner as a mathematical or clerical error and immediately assess any additional tax against that partner.

As under present law, the IRS may challenge the reporting position of a partnership by conducting a single administrative proceeding to resolve the issue with respect to all partners. Unlike under present law, however, partners will have no right individually to participate in settlement conferences or to request a refund.

Partnership representative.—The bill requires each electing large partnership to designate a partner or other person to act on its behalf. If an electing large partnership fails to designate such a person, the IRS is permitted to designate any one of the partners as the person authorized to act on the partnership's behalf. After the IRS's designation, an electing large partnership could still designate a replacement for the IRS-designated partner.

Notice requirements.—Unlike under present law, the IRS is not required to give notice to individual partners of the commencement of an administrative proceeding or of a final adjustment. Instead, the IRS is authorized to send notice of a partnership adjustment to the partnership itself by certified or registered mail. The IRS could give proper notice by mailing the notice to the last known address of the partnership, even if the partnership had terminated its existence.

Adjudication of disputes concerning partnership items.—As under present law, an administrative adjustment could be challenged in the Tax Court, the district court in which the partner-

ship's principal place of business is located, or the Claims Court. However, only the partnership, and not partners individually, can petition for a readjustment of partnership items.

If a petition for readjustment of partnership items is filed by the partnership, the court with which the petition is filed will have jurisdiction to determine the tax treatment of all partnership items of the partnership for the partnership taxable year to which the notice of partnership adjustment relates, and the proper allocation of such items among the partners. Thus, the court's jurisdiction is not limited to the items adjusted in the notice.

Statute of limitations.—Absent an agreement to extend the statute of limitations, the IRS generally could not adjust a partnership item of an electing large partnership more than 3 years after the later of the filing of the partnership return or the last day for the filing of the partnership return. Special rules apply to false or fraudulent returns, a substantial omission of income, or the failure to file a return. The IRS would assess and collect any deficiency of a partner that arises from any adjustment to a partnership item subject to the limitations period on assessments and collection applicable to the year the adjustment takes effect (secs. 6248, 6501 and 6502).

Regulatory authority.—The Secretary of the Treasury is granted authority to prescribe regulations as may be necessary to carry out the simplified audit procedure provisions, including regulations to prevent abuse of the provisions through manipulation. The regulations may include rules that address transfers of partnership interests, in anticipation of a partnership adjustment, to persons who are tax-favored (e.g., corporations with net operating losses, tax-exempt organizations, and foreign partners) or persons who are expected to be unable to pay tax (e.g., shell corporations). For example, if prior to the time a partnership adjustment takes effect, a taxable partner transfers a partnership interest to a nonresident alien to avoid the tax effect of the partnership adjustment, the rules may provide, among other things, that income related to the partnership adjustment is treated as effectively connected taxable income, that the partnership adjustment is treated as taking effect before the partnership interest was transferred, or that the former partner is treated as a current partner to whom the partnership adjustment is allocated.

Effective date.—The provision applies to partnership taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with technical modifications.

[¶ 12,275] Act Sec. 1223. Law at ¶ 5581 and 5711. CCH Explanation at ¶ 430.

Partnership Simplification Provisions—General

House Committee Report

[*Furnishing information to partners of electing large partnerships*]

Due date for furnishing information to partners of electing large partnerships.—The bill provides that an electing large partnership must furnish information returns to partners by the first March 15 following the close of the partnership's taxable year. Electing large partnerships are those partnerships subject to the simplified reporting and audit rules (generally, any partnership that elects under the reporting provision, if the number of partners in the preceding taxable year is 100 or more).

The provision also provides that, if the partnership is required to provide copies of the information returns to the Internal Revenue Service on magnetic media, each schedule (such as each Schedule K-1) with respect to each partner is treated as a separate information return with respect to the corrective periods and penalties that are generally applicable to all information returns.

Effective date.—The provision is effective for partnership taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,285] Act Sec. 1224. Law at ¶ 5573. CCH Explanation at ¶ 469.

Partnership Simplification Provisions—General

House Committee Report

[*Partnership returns on magnetic media*]

Partnership returns required on magnetic media.—The bill provides generally that any partnership is required to provide the tax return of the partnership (Form 1065), as well as copies of the schedule sent to each partner (Form K-1), to the Internal Revenue Service on magnetic media. An exception is provided for partnerships with 100 or fewer partners.

Effective date.—The provision is effective for partnership taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,295] Act Sec. 1225. Law at ¶ 5575. CCH Explanation at ¶ 183.

Partnership Simplification Provisions—General

House Committee Report

[*Partnership items of IRAs*]

Treatment of partnership items of individual retirement arrangements.—The bill modifies the filing threshold for an IRA with an interest in a partnership that is subject to the partnership-level audit rules. A fiduciary of such an IRA could treat the trust's share of partnership taxable income as gross income, for purposes of determining whether the trust meets the $1,000 gross income filing threshold. A fiduciary of an IRA that receives taxable income from a partnership that is subject to partnership-level audit rules of less than $1,000 (before the $1,000 specific deduction) is not required to file an income tax return if the IRA does not have any other income from an unrelated trade or business.

Effective date.—The provision applies to taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,315] Act Sec. 1231. Law at ¶ 5619 and 5639. CCH Explanation at ¶ 431.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Partnership items in deficiency proceedings*]

Treatment of partnership items in deficiency proceedings.—The bill overrules *Munro* and allow the IRS to return to its prior practice of computing deficiencies by assuming that all TEFRA items whose treatment has not been finally determined had been correctly reported on the taxpayer's return. This eliminates the need to do special computations that involve the removal of TEFRA items from a taxpayer's return, and will restore to taxpayers a prepayment forum with respect to the TEFRA items. In addition, the provision provides a special rule to address the factual situation presented in *Munro*.

Specifically, the bill provides a declaratory judgment procedure in the Tax Court for adjustments to an oversheltered return. An oversheltered return is a return that shows no taxable income and a net loss from TEFRA partnerships. In such a case, the IRS is authorized to issue a notice of adjustment with respect to non-TEFRA items, notwithstanding that no deficiency would result from the adjustment. However, the IRS could only issue such a notice if a deficiency would have arisen in the absence of the net loss from TEFRA partnerships.

The Tax Court is granted jurisdiction to determine the correctness of such an adjustment as well as to make a declaration with respect to any other item for the taxable year to which the notice of adjustment relates, except for partnership items and affected items which require partner-level determinations. No tax is due upon such a determination, but a decision of the Tax Court is treated as a final decision, permitting an appeal of the decision by either the taxpayer or the IRS. An adjustment determined to be correct would thus have the effect of increasing the taxable

income that is deemed to have been reported on the taxpayer's return. If the taxpayer's partnership items were then adjusted in a subsequent proceeding, the IRS has preserved its ability to collect tax on any increased deficiency attributable to the nonpartnership items.

Alternatively, if the taxpayer chooses not to contest the notice of adjustment within the 90-day period, the bill provides that when the taxpayer's partnership items are finally determined, the taxpayer has the right to file a refund claim for tax attributable to the items adjusted by the earlier notice of adjustment for the taxable year. Although a refund claim is not generally permitted with respect to a deficiency arising from a TEFRA proceeding, such a rule is appropriate with respect to a defaulted notice of adjustment because taxpayers may not challenge such a notice when issued since it does not require the payment of additional tax.

In addition, the bill incorporates a number of provisions intended to clarify the coordination between TEFRA audit proceedings and individual deficiency proceedings. Under these provisions, any adjustment with respect to a nonpartnership item that caused an increase in tax liability with respect to a partnership item would be treated as a computational adjustment and assessed after the conclusion of the TEFRA proceeding. Accordingly, deficiency procedures do not apply with respect to this increase in tax liability, and the statute of limitations applicable to TEFRA proceedings are controlling.

Effective date.—The provision is effective for partnership taxable years ending after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,320] Act Sec. 1232. Law at ¶ 5637. CCH Explanation at ¶ 435.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Partnership return determines audit procedures*]

Partnership return to be determinative of audit procedures to be followed.—The bill permits the IRS to apply the TEFRA audit procedures if, based on the partnership's return for the year, the IRS reasonably determines that those procedures should apply. Similarly, the provision permits the IRS to apply the normal deficiency procedures if, based on the partnership's return for the year, the IRS reasonably determines that those procedures should apply.

Effective date.—The provision is effective for partnership taxable years ending after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,325] Act Sec. 1233(a). Law at ¶ 5633. CCH Explanation at ¶ 437.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Statute of limitations: Untimely petitions*]

Provisions relating to statute of limitations.—

Suspend statute when an untimely petition is filed.—The bill conforms the suspension rule for the filing of petitions in TEFRA cases with the rule under section 6503(a) pertaining to deficiency cases. Under the provision, the statute of limitations in TEFRA cases is suspended by the filing of any petition under section 6226, regardless of whether the petition is timely or valid, and the suspension will remain in effect until the decision of the court becomes final, and for one year thereafter. Hence, if the statute of limitations is open at the time that an untimely petition is filed, the limitations period would no longer continue to run and possibly expire while the action is pending before the court.

Effective date.—The provision is effective with respect to all cases in which the period of limitations has not expired under present law as of the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,330] Act Sec. 1233(b). Law at ¶ 5633. CCH Explanation at ¶ 438.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Statute of limitations: Bankruptcy proceedings*]

Provisions relating to statute of limitations.—

Suspend statute of limitations during bankruptcy proceedings.—The bill clarifies that the statute of limitations is suspended for a partner who is named in a bankruptcy petition. The suspension period is for the entire period during which the IRS is prohibited by reason of the bankruptcy proceeding from making an assessment, and for 60 days thereafter. The provision does not purport to create any inference as to the proper interpretation of present law.

Effective date.—The provision is effective with respect to all cases in which the period of limitations has not expired under present law as of the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,335] Act Sec. 1233(c). Law at ¶ 5633. CCH Explanation at ¶ 439.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Statute of limitations: Bankrupt TMPs*]

Provisions relating to statute of limitations.—

Extend statute of limitations for bankrupt TMPs.—The bill provides that unless the IRS is notified of a bankruptcy proceeding in accordance with regulations, the IRS can rely on a statute extension signed by a person who is the tax matters partner but for the fact that said person was in bankruptcy at the time that the person signed the agreement. Statute extensions granted by a bankrupt TMP in these cases are binding on all of the partners in the partnership. The provision is not intended to create any inference as to the proper interpretation of present law.

Effective date.—The provision is effective for extension agreements entered into after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,345] Act Sec. 1234. Law at ¶ 5637. CCH Explanation at ¶ 445.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Small partnership exception*]

Expansion of small partnership exception.—The bill permits a small partnership to have a C corporation as a partner or to specially allocate items without jeopardizing its exception from the TEFRA rules. However, the provision retains the prohibition of present law against having a flow-through entity (other than an estate of a deceased partner) as a partner for purposes of qualifying for the small partnership exception.

Effective date.—The provision is effective for partnership taxable years ending after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,350] Act Sec. 1235. Law at ¶ 5633. CCH Explanation at ¶ 443.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Partial settlements: Assessment limitation*]

Exclusion of partial settlements from 1-year limitation on assessment.—The bill provides that if a partner and the IRS enter into a settlement agreement with respect to some but not all of the partnership items in dispute for a partnership taxable year and other partnership items remain in dispute, the period for assessing any tax attributable to the settled items is determined as if such agreement had not been entered into. Consequently, the limitations period that is applicable to the last item to be resolved for the partnership taxable year is controlling with respect to all disputed partnership items for the partnership taxable year. The provision does not purport to create any inference as to the proper interpretation of present law.

Effective date.—The provision is effective for settlements entered into after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,355] Act Sec. 1236. Law at ¶ 5631. CCH Explanation at ¶ 447.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Administrative adjustment requests*]

Extension of time for filing a request for administrative adjustment.—The bill provides that if a TEFRA statute extension agreement is entered into, that agreement also extends the statute of limitations for filing refund claims attributable to partnership items or affected items until 6 months after the expiration of the limitations period for assessments.

Effective date.—The provision is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,360] Act Sec. 1237. Law at ¶ 5635 and 5677. CCH Explanation at ¶ 451.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Innocent spouse relief*]

Availability of innocent spouse relief in context of partnership proceedings.—The bill provides both a prepayment forum and a refund forum for raising the innocent spouse defense in TEFRA cases.

With respect to a prepayment forum, the provision provides that within 60 days of the date that a notice of computational adjustment relating to partnership items is mailed to the spouse of a partner, the spouse could request that the assessment be abated. Upon receipt of such a request, the assessment is abated and any reassessment will be subject to the deficiency procedures. If an abatement is requested, the statute of limitations does not expire before the date which is 60 days after the date of the abatement. If the spouse files a petition with the Tax Court, the Tax Court only has jurisdiction to determine whether the requirements of section 6013(e) have been satisfied. In making this determination, the treatment of the partnership items that gave rise to the liability in question is conclusive.

Alternatively, the bill provides that the spouse of a partner could file a claim for refund to raise the innocent spouse defense. The claim has to be filed within 6 months from the date that the notice of computational adjustment is mailed to the spouse. If the claim is not allowed, the spouse could file a refund action. For purposes of any claim or suit under this provision, the treatment of the partnership items that gave rise to the liability in question is conclusive.

Effective date.—The provision is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,365] Act Sec. 1238. Law at ¶ 5625, 5629 and 5635. CCH Explanation at ¶ 453.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Penalties determined at partnership level*]

Determination of penalties at partnership level.—The bill provides that the partnership-level proceeding is to include a determination of the applicability of penalties at the partnership level. However, the provision allows partners to raise any partner-level defenses in a refund forum.

Effective date.—The provision is effective for partnership taxable years ending after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with technical modifications.

[¶ 12,370] Act Sec. 1239. Law at ¶ 5627, 5629, 5635, 5675, 5683, 5715, 5727 and 5735. CCH Explanation at ¶ 455.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Tax Court jurisdiction*]

Provisions relating to Tax Court jurisdiction.—The bill clarifies that an action to enjoin premature assessments of deficiencies attributable to partnership items may be brought in the Tax Court. The provision also permits a partner to participate in an action or file a petition for the sole purpose of asserting that the period of limitations for assessing any tax attributable to partnership items has expired for that person. Additionally, the provision clarifies that the Tax Court has overpayment jurisdiction with respect to affected items.

Effective date.—The provision is effective for partnership taxable years ending after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with technical modifications.

[¶ 12,375] Act Sec. 1240. Law at ¶ 5629. CCH Explanation at ¶ 457.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Premature petitions: Notice partners or 5-percent groups*]

Treatment of premature petitions filed by notice partners or 5-percent groups.—The bill treats premature petitions filed by certain partners within the 90-day period as being filed on the last day of the following 60-day period under specified circumstances, thus affording the partnership with an opportunity for judicial review that is not available under present law.

Effective date.—The provision is effective with respect to petitions filed after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,380] Act Sec. 1241. Law at ¶ 5737. CCH Explanation at ¶ 459.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Bonds in case of appeals*]

Bonds in case of appeals from certain proceedings.—The bill clarifies that the amount of the bond should be based on the Tax Court's estimate of the aggregate liability of the parties to the action (and not all of the partners in the partnership). For purposes of this provision, the amount of the bond could be estimated by applying the highest individual rate to the total adjustments determined by the Tax Court and doubling that amount to take into account interest and penalties.

Effective date.—The provision is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,385] Act Sec. 1242. Law at ¶ 5685. CCH Explanation at ¶ 461.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Suspension of interest*]

Suspension of interest where delay in computational adjustment resulting from certain settlements.—The bill suspends interest where there is a delay in making a computational adjustment relating to a TEFRA settlement.

Effective date.—The provision is effective with respect to adjustments relating to taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,390] Act Sec. 1243. Law at ¶ 5631. CCH Explanation at ¶ 449.

Partnership Simplification Provisions—Other Audit Rules

House Committee Report

[*Administrative adjustment requests: Bad debts or worthless securities*]

Special rules for administrative adjustment requests with respect to bad debts or worthless securities.—The bill extends the time for the filing of an RAA relating to the deduction by a partnership for a worthless security or bad debt. In these circumstances, in lieu of the three-year period provided in sec. 6227(a)(1), the period for filing an RAA is seven years from the date the partnership return was due with respect to which the request is made (determined without regard to extensions). The RAA is still required to be filed before the FPAA is mailed for the taxable year.

Effective date.—The provision is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,415] Act Sec. 1246. Law at ¶ 5219. CCH Explanation at ¶ 465.

Partnership Simplification Provisions

House Committee Report

[*Tax year with respect to deceased partner*]

Closing of partnership taxable year with respect to deceased partner.—The bill provides that the taxable year of a partnership closes with respect to a partner whose entire interest in the partnership terminates, whether by death, liquidation or otherwise. The bill does not change present law with respect to the effect upon the partnership taxable year of a transfer of a partnership interest by a debtor to the debtor's estate (under Chapters 7 or 11 of Title 11, relating to bankruptcy).

Effective date.—The provision applies to partnership taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,435] Act Sec. 1251 and 1263. Law at ¶ 5267 and 5269. CCH Explanation at ¶ 539.

Real Estate Investment Trusts

House Committee Report

[*Maximum number of shareholders*]

Modification of rules for real estate investment trusts.—

Overview.—The bill modifies many of the provisions relating to the requirements for qualification as, and the taxation of, a REIT. In particular, the modifications relate to the general requirements for qualification as a REIT, the taxation of a REIT, the income requirements for qualification as a 'REIT, and certain other provisions.

Clarification of limitation on maximum number of shareholders.—The bill replaces the rule that disqualifies a REIT for any year in which the REIT failed to comply with Treasury regulations to ascertain its ownership, with an intermediate penalty for failing to do so. The penalty would be $25,000 ($50,000 for intentional violations) for any year in which the REIT did not comply with the ownership regulations. The REIT also is required, when requested by the IRS, to send curative demand letters.

In addition, a REIT that complied with the Treasury regulations for ascertaining its ownership, and which did not know, or have reason to know, that it was so closely held as to be classified as a personal holding company, is treated as meeting the requirement that it not be a personal holding company.

* * *

Effective date.—The bill is effective for taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is identical to the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

Effective date.—The conference agreement is effective for taxable years beginning after the date of enactment.

[¶ 12,440] Act Sec. 1252 and 1263. Law at ¶ 5267. CCH Explanation at ¶ 541.

Real Estate Investment Trusts

House Committee Report

[*Tenant service income*]

Modification of rules for real estate investment trusts.—

* * *

De minimis rule for tenant service income.— The bill permits a REIT to render a *de minimis* amount of impermissible services to tenants, or in connection with the management of property, and still treat amounts received with respect to that property as rent. The value of the impermissible services may not exceed one percent of the gross income from the property. For these purposes, the services may not be valued at less than 150 percent of the REIT's direct cost of the services.

* * *

*Effective date.—*The bill is effective for taxable years beginning after the date of enactment.

Conference Committee Report

*Senate Amendment.—*The Senate amendment is identical to the House bill.

*Conference Agreement.—*The conference agreement follows the House bill and the Senate amendment. * * *

*Effective date.—*The conference agreement is effective for taxable years beginning after the date of enactment.

[¶ 12,445] Act Sec. 1253 and 1263. Law at ¶ 5267. CCH Explanation at ¶ 543.

Real Estate Investment Trusts

House Committee Report

[*Attribution: Tenant ownership*]

Modification of rules for real estate investment trusts.—

* * *

*Attribution rules applicable to tenant ownership.—*The bill modifies the application of section 318(a)(3)(A) (attribution to partnerships) for purposes of defining rent in section 856(d)(2), so that attribution occurs only when a partner owns a 25 percent or greater interest in the partnership.

* * *

*Effective date.—*The bill is effective for taxable years beginning after the date of enactment.

Conference Committee Report

*Senate Amendment.—*The Senate amendment is identical to the House bill.

*Conference Agreement.—*The conference agreement follows the House bill and the Senate amendment. In addition, the conference agreement extends, to the definition of an independent contractor under section 856(d)(3), the modification to the attribution to partnerships of section 318(a)(3)(A) so that attribution occurs only when a partner owns a 25-percent or greater interest in the partnership. Thus, a person providing services will not fail to be an independent contractor (and, therefore, amounts received or accrued by the REIT with respect to the property will not be treated as non-qualifying rents) where the REIT's shares are owned by a partnership and a partner owning a directly and indirectly a less-than-25-percent interest in the partnership also owns an interest in a contractor. Similarly, a contractor will not fail to be an independent contractor where owners of the REIT and owners of the contractor are partners in a partnership and either the owners of the REIT or owners of the tenant are directly and indirectly less-than-25-percent partners in the partnership.

*Effective date.—*The conference agreement is effective for taxable years beginning after the date of enactment.

[¶ 12,450] Act Sec. 1254 and 1263. Law at ¶ 5263 and 5269. CCH Explanation at ¶ 545.

Real Estate Investment Trusts

House Committee Report

[*Retained capital gains tax credit*]

Modification of rules for real estate investment trusts.—

* * *

Credit for tax paid by REIT on retained capital gains.—The bill permits a REIT to elect to retain and pay income tax on net long-term capital gains it received during the tax year, just as a RIC is permitted under present law. Thus, if a REIT made this election, the REIT shareholders would include in their income as long-term capital gains their proportionate share of the undistributed long-term capital gains as designated by the REIT. The shareholder would be deemed to have paid the shareholder's share of the tax, which would be credited or refunded to the shareholder. Also, the basis of the shareholder's shares would be increased by the amount of the undistributed long-term capital gains (less the amount of capital gains tax paid by the REIT) included in the shareholder's long-term capital gains.

* * *

Effective date.—The bill is effective for taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is identical to the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

Effective date.—The conference agreement is effective for taxable years beginning after the date of enactment.

[¶ 12,455]Act Sec. 1255 and 1263. Law at ¶ 5267 and 5269. CCH Explanation at ¶ 547.

Real Estate Investment Trusts

House Committee Report

[*30-percent gross income requirement*]

Modification of rules for real estate investment trusts.—

* * *

Repeal of 30-percent gross income requirement.—The bill repeals the rule that requires less than 30 percent of a REIT's gross income be derived from gain from the sale or other disposition of stock or securities held for less than one year, certain real property held less than four years, and property that is sold or disposed of in a prohibited transaction.

* * *

Effective date.—The bill is effective for taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is identical to the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

Effective date.—The conference agreement is effective for taxable years beginning after the date of enactment.

[¶ 12,460] Act Sec. 1256 and 1263. Law at ¶ 5269. CCH Explanation at ¶ 549.

Real Estate Investment Trusts

House Committee Report

[*Earnings and profits rules*]

Modification of rules for real estate investment trusts.—

* * *

Modification of earnings and profits for determining whether REIT has earnings and profits from non-REIT year.—The bill changes the ordering rule for purposes of the requirement that newly-electing REITs distribute earnings and profits that were accumulated in non-REIT years. Under the bill, distributions of accumulated earnings and profits generally are treated as made from the entity's earliest accumulated earnings and profits, rather than the most recently accu-

mulated earnings and profits. These distributions are not treated as distributions for purposes of calculating the dividends paid deduction.

* * *

Effective date.—The bill is effective for taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is identical to the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

Effective date.—The conference agreement is effective for taxable years beginning after the date of enactment.

[¶ 12,465] Act Sec. 1257 and 1263. Law at ¶ 5267. CCH Explanation at ¶ 551.

Real Estate Investment Trusts

House Committee Report

[*Foreclosure property*]

Modification of rules for real estate investment trusts.—

* * *

Treatment of foreclosure property.—The bill lengthens the original grace period for foreclosure property until the last day of the third full taxable year following the election. The grace period also could be extended for an additional three years by filing a request to the IRS. Under the bill, a REIT could revoke an election to treat property as foreclosure property for any taxable year by filing a revocation on or before its due date for filing its tax return.

In addition, the bill conforms the definition of independent contractor for purposes of the foreclosure property rule (sec. 856(e)(4)(C)) to the definition of independent contractor for purposes of the general rules (sec. 856(d)(2)(C)).

* * *

Effective date.—The bill is effective for taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is identical to the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

Effective date.—The conference agreement is effective for taxable years beginning after the date of enactment.

[¶ 12,470] Act Sec. 1258 and 1263. Law at ¶ 5267. CCH Explanation at ¶ 553.

Real Estate Investment Trusts

House Committee Report

[*Hedging instruments*]

Modification of rules for real estate investment trusts.—

* * *

Payments under hedging instruments.—The bill treats income from all hedges that reduce the interest rate risk of REIT liabilities, not just from interest rate swaps and caps, as qualifying income under the 95-percent test. Thus, payments to a REIT under an interest rate swap, cap agreement, option, futures contract, forward rate agreement or any similar financial instrument entered into by the REIT to hedge its indebtedness incurred or to be incurred (and any gain from the sale or other disposition of these instruments) are treated as qualifying income for purposes of the 95-percent test.

* * *

Effective date.—The bill is effective for taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is identical to the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

Effective date.—The conference agreement is effective for taxable years beginning after the date of enactment.

[¶ 12,475] Act Sec. 1259 and 1263. Law at ¶ 5269. CCH Explanation at ¶ 555.

Real Estate Investment Trusts

House Committee Report

[*Excess noncash income*]

Modification of rules for real estate investment trusts.—

* * *

Excess noncash income.—The bill (1) expands the class of excess noncash items that are not subject to the distribution requirement to include income from the cancellation of indebtedness and (2) extends the treatment of original issue discount and coupon interest as excess noncash items to REITs that use an accrual method of taxation.

* * *

Effective date.—The bill is effective for taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is identical to the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

Effective date.—The conference agreement is effective for taxable years beginning after the date of enactment.

[¶ 12,480] Act Sec. 1260 and 1263. Law at ¶ 5269. CCH Explanation at ¶ 557.

Real Estate Investment Trusts

House Committee Report

[*Prohibited transaction safe harbor*]

Modification of rules for real estate investment trusts.—

* * *

Prohibited transaction safe harbor.—The bill excludes from the prohibited sales rules property that was involuntarily converted.

* * *

Effective date.—The bill is effective for taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is identical to the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

Effective date.—The conference agreement is effective for taxable years beginning after the date of enactment.

[¶ 12,485] Act Sec. 1261 and 1263. Law at ¶ 5267. CCH Explanation at ¶ 559.

Real Estate Investment Trusts

House Committee Report

[*Shared appreciation mortgages*]

Modification of rules for real estate investment trusts.—

* * *

Shared appreciation mortgages.—The bill provides that interest received on a shared appreciation mortgage is not subject to the tax on prohibited transactions where the property subject to the mortgage is sold within 4 years of the REIT's acquisition of the mortgage pursuant to a bankruptcy plan of the mortgagor unless the REIT acquired the mortgage knew or had reason to know that the property subject to the mortgage would be sold in a bankruptcy proceeding.

* * *

Effective date.—The bill is effective for taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is identical to the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

Effective date.—The conference agreement is effective for taxable years beginning after the date of enactment.

[¶ 12,490] Act Sec. 1262 and 1263. Law at ¶ 5267. CCH Explanation at ¶ 561.

Real Estate Investment Trusts

House Committee Report

[*Wholly owned subsidiaries*]

Modification of rules for real estate investment trusts.—

* * *

Wholly owned REIT subsidiaries.—The bill permits any corporation wholly owned by a REIT to be treated as a qualified subsidiary, regardless of whether the corporation had always been owned by the REIT. Where the REIT acquired an existing corporation, the bill treats any such corporation as being liquidated as of the time of acquisition by the REIT and then reincorporated (thus, any of the subsidiary's pre-REIT built-in gain would be subject to tax under the normal rules of section 337). In addition, any pre-REIT earnings and profits of the subsidiary must be distributed before the end of the REIT's taxable year.

Effective date.—The bill is effective for taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is identical to the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

Effective date.—The conference agreement is effective for taxable years beginning after the date of enactment.

[¶ 12,515] Act Sec. 1271. Law at ¶ 5255, 5261 and 5339. CCH Explanation at ¶ 535.

Regulated Investment Companies

House Committee Report

[*Short-short test*]

Repeal the short-short test for regulated investment companies.—The 30-percent test (or short-short rule) is repealed.

Effective date.—The provision is effective for taxable years ending after the date of enactment.

Conference Committee Report

Senate Amendment.—The 30-percent test (or short-short rule) is repealed effective for taxable years beginning after the December 31, 1997.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment effective for taxable years beginning after the date of enactment.

[¶ 12,535] Act Sec. 1281. Law at ¶ 5691, 5701 and 5743. CCH Explanation at ¶ 1001.

Taxpayer Protections

House Committee Report

[*Penalties: Reasonable cause exception*]

Provide reasonable cause exception for additional penalties.—The bill provides that the following penalties may be waived if the failure is shown to be due to reasonable cause and not willful neglect:

(1) the penalty for failure to make a report in connection with deductible employee contributions to a retirement savings plan (sec. 6652(g));

(2) the penalty for failure to make a report as to certain small business stock (sec. 6652(k));

(3) the penalty for failure of a foreign corporation to file a return of personal holding company tax (sec. 6683); and

(4) the penalty for failure to make required payments for entities electing not to have the required taxable year (sec. 7519).

Effective date.—The provision is effective for taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,540] Act Sec. 1282. Law at ¶ 5683. CCH Explanation at ¶ 1010.

Taxpayer Protections

House Committee Report

[*Refund claims: Time to file*]

Clarification of period for filing claims for refund.—The bill permits taxpayers who initially fail to file a return, but who receive a notice of deficiency and file suit to contest it in Tax Court during the third year after the return due date, to obtain a refund of excessive amounts paid within the 3-year period prior to the date of the deficiency notice.

Effective date.—The provision applies to claims for refund with respect to tax years ending after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,545] Act Sec. 1283. Law at ¶ 5613. CCH Explanation at ¶ 1070.

Taxpayer Protections

House Committee Report

[*Disclosure audit of prospective juror*]

Repeal of authority to disclose whether a prospective juror has been audited.—The bill repeals the requirement that the Secretary disclose, upon the written request of either party to the lawsuit, whether an individual who is a prospective juror has or has not been the subject of an audit or other tax investigation by the Internal Revenue Service.

Effective date.—The provision is effective for judicial proceedings commenced after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,550] Act Sec. 1284. Law at ¶ 5675. CCH Explanation at ¶ 1013.

Taxpayer Protections

House Committee Report

[*Statute of limitations: Pass-through entity items*]

Clarify statute of limitations for items from pass-through entities.—The bill clarifies that the return that starts the running of the statute of limitations for a taxpayer is the return of the taxpayer and not the return of another person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit.

Effective date.—The provision is effective for taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,555] Act Sec. 1285. Law at ¶ 5717. CCH Explanation at ¶ 1016.

Taxpayer Protections

House Committee Report

[*Awarding administrative costs*]

Awarding of administrative costs and attorneys fees.—The bill provides that a taxpayer who seeks an award of administrative costs must apply for such costs within 90 days of the date on which the taxpayer was determined to be a prevailing party. The bill also provides that a taxpayer who seeks to appeal an IRS denial of an administrative cost award must petition the Tax Court within 90 days after the date that the IRS mails the denial notice.

The bill clarifies that dispositions by the Tax Court of petitions relating only to administrative costs are to be reviewed in the same manner as other decisions of the Tax Court.

Effective date.—The provision is effective with respect to costs incurred in civil actions or proceedings commenced after the date of enactment.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 12,615] Act Sec. 1301. Law at ¶ 5579. CCH Explanation at ¶ 253.

Estate, Gift, and Trust Simplification

House Committee Report

[*Charitable gifts: Gift tax filing*]

Eliminate gift tax filing requirements for gifts to charities.—The bill provides that gifts to charity are not subject to the gift tax filing requirements of section 6019, as long as the entire value of the transferred property qualifies for the gift tax charitable deduction under section 2522. The filing requirements for gifts of partial interests in property remain unchanged.

Effective date.—The provision is effective for gifts made after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with a technical clarification that the property given to charity must be the donor's entire interest in the property.

[¶ 12,620] Act Sec. 1302. Law at ¶ 5445 and 5447. CCH Explanation at ¶ 243.

Estate, Gift, and Trust Simplification

House Committee Report

[*Waiver of recovery rights*]

Clarification of waiver of certain rights of recovery.—The bill provides that the right of recovery with respect to QTIP is waived only to the extent that language in the decedent's will or revocable trust specifically so indicates (e.g., by a specific reference to QTIP, the QTIP trust, section 2044, or section 2207A). Thus, a general provision specifying that all taxes be paid by the estate is no longer sufficient to waive the right of recovery.

The bill also provides that the right of contribution for property over which the decedent retained enjoyment or the right to income is waived by a specific indication in the decedent's will or revocable trust, but specific reference to section 2207B is no longer required.

Effective date.—The provision applies to decedents dying after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,625] Act Sec. 1303. Law at ¶ 5437. CCH Explanation at ¶ 233.

Estate, Gift, and Trust Simplification

House Committee Report

[*Code Sec. 2056A transitional rule*]

Transitional rule under section 2056A.—Certain trusts created before the enactment of the Omnibus Budget Reconciliation Act of 1990 are treated as satisfying the withholding requirement if the governing instruments require that all trustees be U.S. citizens or domestic corporations.

Effective date.—The provision applies as if included in the Omnibus Budget Reconciliation Act of 1990.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,630] Act Sec. 1304. Law at ¶ 5441. CCH Explanation at ¶ 212.

Estate, Gift, and Trust Simplification

Houses Committee Report

[*Nonresident alien short-term obligations*]

Treatment for estate tax purposes of short-term obligations held by nonresident aliens.—The bill provides that any debt obligation, the income from which would be eligible for the exemption for short-term OID under section 871(g)(1)(B)(I) if such income were received by the decedent on the date of his death, is treated as property located outside of the United States in determining the U.S. estate tax liability of a nonresident not a U.S. citizen. No inference is intended with respect to the estate tax treatment of such obligations under present law.

Effective date.—The provision is effective for estates of decedents dying after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,635] Act Sec. 1305. Law at ¶ 5199 and 5465. CCH Explanation at ¶ 261.

Estate, Gift and Trust Simplification

House Committee Report

[*Revocable trusts as part of estate*]

Certain revocable trusts treated as part of estate.—The bill provides an irrevocable election to treat a qualified revocable trust as part of the decedent's estate for Federal income tax purposes. This elective treatment is effective from the date of the decedent's death until two years after his or her death (if no estate tax return is required) or, if later, six months after the final determination of estate tax liability (if an estate tax return is required). The election must be made by both the executor of the decedent's estate (if any) and the trustee of the revocable trust no later than the time required for filing the income tax return of the estate for its first taxable year, taking into account any extensions. A conforming change is made to section 2652(b) for generation-skipping transfer tax purposes.

For this purpose, a qualified revocable trust is any trust (or portion thereof) which was treated under section 676 as owned by the decedent with respect to whom the election is being made, by reason of a power in the grantor (i.e., trusts that are treated as owned by the decedent solely by reason of a power in a nonadverse party would not qualify).

As described below, the separate share rule may apply when a qualified revocable trust is treated as part of the decedent's estate.

Effective date.—The provision applies to decedents dying after the date of enactment.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 12,640] Act Sec. 1306. Law at ¶ 5201. CCH Explanation at ¶ 264.

Estate, Gift, and Trust Simplification

House Committee Report

[*Estate distributions: 65-day rule*]

Distributions during first 65 days of taxable year of estate.—The bill extends application of the 65-day rule to distributions by estates. Thus, an executor can elect to treat distributions paid within 65 days after the close of the estate's taxable year as having been paid on the last day of such taxable year.

Effective date.—The provision applies to taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,645] Act Sec. 1307. Law at ¶ 5201. CCH Explanation at ¶ 267.

Estate, Gift, and Trust Simplification

House Committee Report

[*Estates: Separate share rules*]

Separate share rules available to estates.—The bill extends the application of the separate share rule to estates. There are separate shares in an estate when the governing instrument of the estate (e.g., the will and applicable local law) creates separate economic interests in one beneficiary or class of beneficiaries such that the economic interests of those beneficiaries (e.g., rights to income or gains from specified items of property) are not affected by economic interests accruing to another separate beneficiary or class of beneficiaries. For example, a separate share in an estate would exist where the decedent's will provides that all of the shares of a closely-held corporation are devised to one beneficiary and that any dividends paid to the estate by that corporation should be paid only to that beneficiary and any such dividends would not affect any other amounts which that beneficiary would receive under the will. As in the case of trusts, the application of the separate share rule is mandatory where separate shares exist.

Effective date.—The provision applies to decedents dying after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,650] Act Sec. 1308. Law at ¶ 5101 and 5349. CCH Explanation at ¶ 270.

Estate, Gift, and Trust Simplification

House Committee Report

[*Loss disallowances: Executors and beneficiaries*]

Executor of estate and beneficiaries treated as related persons for disallowance of losses.—Under the bill, an estate and a beneficiary of that estate are treated as related persons for purposes of sections 267 and 1239, except in the case of a sale or exchange in satisfaction of a pecuniary bequest.

Effective date.—The provision applies to taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,655] Act Sec. 1309. Law at ¶ 5213. CCH Explanation at ¶ 286.

Estate, Gift, and Trust Simplification

House Committee Report

[*Pre-need funeral trusts*]

Simplified taxation of earnings of pre-need funeral trusts.—The bill allows the trustee of a pre-need funeral trust to elect special tax treatment for such a trust, to the extent the trust would otherwise be treated as a grantor trust. A qualified funeral trust is defined as one which meets the following requirements: (1) the trust arises as the result of a contract between a person engaged in the trade or business of providing funeral or burial services or merchandise and one or more individuals to have such services or property provided upon such individuals' death; (2) the only beneficiaries of the trust are individuals who have entered into contracts to have such services or merchandise provided upon their death; (3) the only contributions to the trust are contributions by or for the benefit of the trust beneficiaries; (4) the trust's only purpose is to hold and invest funds that will be used to make payments for funeral or burial services or merchandise for the trust beneficiaries; and (5) the trust has not accepted contributions totaling more than $7,000 by or for the benefit of any individual. For this purpose, "contributions" include all amounts transferred to the trust, regardless of how denominated in the contract. Contributions do not, however, include income or gain earned with respect to property in the trust. For purposes of applying the $7,000 limit, if a purchaser has more than one contract with a single trustee (or related trustees), all such trusts are treated as one trust. Similarly, if the Secretary of Treasury determines that a purchaser has entered into separate contracts with unrelated trustees to avoid the $7,000 limit described above, the Secretary may require that such trusts be treated as one trust. For contracts entered into after 1998, the $7,000 limit is indexed annually for inflation.

The trustee's election to have this provision apply to a qualified funeral trust is to be made separately with respect to each purchaser's trust. It is anticipated that the Department of Treasury will issue prompt guidance with respect to the simplified reporting the election is made, a single annual trust return may be filed by the trustee, separately listing the amount of income earned with respect to each purchaser. If the election is made, the trust is not treated as a grantor trust and the amount of tax paid with respect to each purchaser's trust is determined in accordance with the income tax rate schedule generally applicable to estates and trusts (Code sec. 1(e)), but no deduction is allowed under section 642(b). The tax on the annual earnings of the trust is payable by the trustee.

As under present law, amounts received from the trust by the seller are treated as payments for services and merchandise and are includible in the gross income of the seller. No gain or loss is recognized to the beneficiary of the trust for payments from the trust to the beneficiary upon cancellation of the contract, and the beneficiary takes a carryover basis in any assets received from the trust upon cancellation.

Effective date.—The provision is effective for taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment with modifications that would (1) allow the provision to be applied to contracts purchased by one individual to have funeral or burial services or merchandise provided for another individual upon that individual's death (to the extent that such arrangements would otherwise be treated as grantor trusts), and (2) allow the election to be made for taxable years *ending* after the date of enactment.

Effective date.—The provision is effective for taxable years ending after the date of enactment.

[¶ 12,660] Act Sec. 1310. Law at ¶ 5429. CCH Explanation at ¶ 210.

Estate, Gift, and Trust Simplification

House Committee Report

[*Gifts within three years of decedent's death*]

Adjustments for gifts within three years of decedent's death.—The provision codifies the rule set forth in the *McNeely* and *Kisling* cases to provide that a transfer from a revocable trust (i.e., a trust described under section 676) is treated as if made directly by the grantor. Thus, an annual exclusion gift from such a trust is not included in the gross estate.

The provision also revises section 2035 to improve its clarity.

Effective date.—The provision applies to decedents dying after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. The provision is not intended to modify the result reached in the *Kisling* case.

[¶ 12,665] Act Sec. 1311. Law at ¶ 5435. CCH Explanation at ¶ 239.

Estate, Gift, and Trust Simplification

House Committee Report

[*Community property: Retirement benefits*]

Clarify relationship between community property rights and retirement benefits.—The bill clarifies that the marital deduction is available with respect to a nonparticipant spouse's interest in an annuity attributable to community property laws where he or she predeceases the participant spouse. Under the bill, the nonparticipant spouse's interest in an annuity arising under the community property laws of a State that passes to the surviving participant spouse may qualify for treatment as QTIP under section 2056(b)(7).

The provision is not intended to create an inference regarding the treatment under present law of a transfer to a surviving spouse of the decedent spouse's interest in an annuity arising under community property laws.

Effective date.—The provision applies to decedents dying, or waivers, transfers and disclaimers made, after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. The provision is not intended to modify the result of the Supreme Court's decision in *Boggs v. Boggs,* 117 S.Ct. 1754 (1997).

[¶ 12,670] Act Sec. 1312. Law at ¶ 5437. CCH Explanation at ¶ 235.

Estate, Gift, and Trust Simplification

House Committee Report

[*Qualified domestic trusts: Non-trust ownership*]

Treatment under qualified domestic trust rules of forms of ownership which are not trusts.—The bill provides the Treasury Department with regulatory authority to treat as trusts legal arrangements that have substantially the same effect as a trust. It is anticipated that such regulations, if any, would only permit a marital deduction with respect to non-trust arrangements under which the U.S. would retain jurisdiction and adequate security to impose U.S. transfer tax on transfers by the surviving spouse of the property transferred by the decedent. Possible arrangements could include the adoption of a bilateral treaty that provides for the collection of U.S. transfer tax from the noncitizen surviving spouse or a closing agreement process under which the surviving spouse waives treaty benefits, allows the U.S. to retain taxing jurisdiction and provides adequate security with respect to such transfer taxes.

Effective date.—The provision applies to decedents dying after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,675] Act Sec. 1313. Law at ¶ 5425. CCH Explanation at ¶ 231.

Estate, Gift, and Trust Simplification

House Committee Report

[*Special use valuation: Defective elections*]

Opportunity to correct certain failures under section 2032A.—The bill extends the procedures allowing subsequent submission of information to any executor who makes the election and submits the recapture agreement, without regard to compliance with the Treasury regulations. Thus, the bill allows the current use valuation election if the executor supplies the required information within a reasonable period of time (not exceeding 90 days) after notification by the IRS. During that time period, the bill also allows the addition of signatures to a previously filed agreement.

The Committee believes that the Treasury Department has taken an unnecessarily restrictive view of the 1984 amendment to section 2032A and intends no inference that the Treasury Department lacks the power, under the law in effect prior to the date of enactment, to correct the situation addressed by this provision. The Committee intends that, with respect to technically defective 2032A elections made prior to the date of enactment, prior law should be applied in a manner consistent with the provision.

Effective date.—The provision applies to decedents dying after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,680] Act Sec. 1314. Law at ¶ 5437. CCH Explanation at ¶ 237.

Estate, Gift, and Trust Simplification

House Committee Report

[*Qualified domestic trusts: U.S. trustee*]

Authority to waive requirement of U.S. trustee for qualified domestic trusts.—In order to permit the establishment of a QDT in those situations where a country prohibits a trust from having a U.S. trustee, the bill provides the Treasury Department with regulatory authority to waive the requirement that a QDT have a U.S. trustee. It is anticipated that such regulations, if any, provide an alternative mechanism under which the U.S. would retain jurisdiction and adequate security to impose U.S. transfer tax on transfers by the surviving spouse of the property transferred by the decedent. For example, one possible mechanism would be a closing agreement process under which the surviving spouse waives treaty benefits, allows the U.S. to retain taxing jurisdiction and provides adequate security with respect to such transfer taxes.

Effective date.—The provision applies to decedents dying after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,715] Act Sec. 1401. Law at ¶ 5471 and 5475. CCH Explanation at ¶ 1241 and ¶ 1245.

Excise Tax Simplification Provisions

House Committee Report

[*After-market alterations: Heavy truck and luxury car excise tax*]

Increase de minimis limit for after-market alterations subject to heavy truck and luxury automobile excise taxes.—The tax on subsequent installation of parts and accessories does not apply to parts and accessories with an aggregate price that does not exceed $1,000. Parts and accessories installed on a vehicle on or before that date are taken into account in determining whether the $1,000 threshold is exceeded. If the aggregate price of the pre-effective date parts and accessories does not exceed $200, they will not be subject to tax unless the aggregate price of all additions exceeds $1,000.

Effective date.—The increase in the threshold for taxing after-market additions under the heavy

truck and luxury car excise taxes is effective on January 1, 1998.

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,725] Act Sec. 1402. Law at ¶ 5475 and 5477. CCH Explanation at ¶ 1239.

Excise Tax Simplification Provisions

House Committee Report

[*Credit for tire tax in lieu of exclusion*]

Modify treatment of tires under the heavy highway vehicle retail excise tax.—The current exclusion of the value of tires installed on a taxable highway vehicle is repealed. Instead, a credit for the amount of manufacturers' excise tax actually paid on the tires is allowed.

Effective date.—The provision is effective after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,755] Act Sec. 1411. Law at ¶ 5541. CCH Explanation at ¶ 1271.

Excise Tax Simplification Provisions

House Committee Report

[*Imported distilled spirits returned to plant*]

Simplification of excise taxes on distilled spirits, wine, and beer.—

Imported distilled spirits returned to plant.—Refunds or credits of the tax are available for imported bottled spirits that are returned to distilled spirits plants.

* * *

Effective date.—* * *[The provision takes] effect on the first day of the calendar quarter that begins at least 90 days after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with a modification delaying the effective date * * * from the first day of the calendar quarter that begins at least 90 days after the date of enactment to the first day of the quarter beginning at least 180 days after such date.

[¶ 12,760] Act Sec. 1412. Law at ¶ 5555. CCH Explanation at ¶ 1272.

Excise Tax Simplification Provisions

House Committee Report

[*Export bonds cancelled*]

Simplification of excise taxes on distilled spirits, wine, and beer.—

* * *

Cancellation of export bonds.—The certification requirement is relaxed to allow the bonds to be canceled if there is such proof of exportation as the Secretary may require.

* * *

Effective date.—* * * [The provision takes] effect on the first day of the calendar quarter that begins at least 90 days after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with a modification delaying the effective date * * * from the first day of the calendar quarter that begins at least 90 days after the date of enactment to the first day of the quarter beginning at least 180 days after such date.

[¶ 12,765] Act Sec. 1413. Law at ¶ 5557. CCH Explanation at ¶ 1273.

Excise Tax Simplification Provisions

House Committee Report

[*Distilled spirits plant records*]

Simplification of excise taxes on distilled spirits, wine, and beer.—

* * *

Location of records of distilled spirits plant.—Records and reports are permitted to be maintained elsewhere other than on the plant premises.

* * *

Effective date.—* * * [The provision takes] effect on the first day of the calendar quarter that begins at least 90 days after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with a modification delaying the effective date * * * from the first day of the calendar quarter that begins at least 90 days after the date of enactment to the first day of the quarter beginning at least 180 days after such date.

[¶ 12,770] Act Sec. 1414. Law at ¶ 5547, 5551 and 5559. CCH Explanation at ¶ 1274.

Excise Tax Simplification Provisions

House Committee Report

[*Brewery to distilled spirits plant transfers*]

Simplification of excise taxes on distilled spirits, wine, and beer.—

* * *

Transfers from brewery to distilled spirits plant.—Beer may be brought from any brewery for use in the production of spirits. Such beer is exempt from excise tax, subject to Treasury regulations.

* * *

Effective date.—* * * [The provision takes] effect on the first day of the calendar quarter that begins at least 90 days after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with a modification delaying the effective date of certain provisions from the first day of the calendar quarter that begins at least 90 days after the date of enactment to the first day of the quarter beginning at least 180 days after such date.

[¶ 12,775] Act Sec. 1415. Law at ¶ 5553 and 5571. CCH Explanation at ¶ 1275.

Excise Tax Simplification Provisions

House Committee Report

[*Wholesale dealer signs*]

Simplification of excise taxes on distilled spirits, wine, and beer.—

* * *

Sign not required for wholesale dealers.—The requirement that a sign be posted is repealed.

* * *

Effective date.—The provision to repeal the requirement that wholesale liquor dealers post a sign outside their place of business takes effect on the date of enactment. * * *

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment * * *.

[¶ 12,780] Act Sec. 1416. Law at ¶ 5545 and 5561. CCH Explanation at ¶ 1280.

Excise Tax Simplification Provisions

House Committee Report

[*Returns of merchantable wine*]

Simplification of excise taxes on distilled spirits, wine, and beer.—

* * *

Refund on returns of merchantable wine.—A refund or credit is available in the case of all domestic wine returned to bond, whether or not unmerchantable.

* * *

Effective date.—* * * [The provision takes] effect on the first day of the calendar quarter that begins at least 90 days after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with a modification delaying the effective date * * * from the first day of the calendar quarter that begins at least 90 days after the date of enactment to the first day of the quarter beginning at least 180 days after such date.

[¶ 12,785] Act Sec. 1417. Law at ¶ 5565. CCH Explanation at ¶ 1281.

Excise Tax Simplification Provisions

House Committee Report

[*Wine sugar limits*]

Simplification of excise taxes on distilled spirits, wine, and beer.—

* * *

Increased sugar limits for certain wine.—Up to 60 percent sugar is permitted in any wine made from juice, such as cranberry or plum juice, with an acid content of 20 or more parts per thousand.

* * *

Effective date.—* * * [The provision takes] effect on the first day of the calendar quarter that begins at least 90 days after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with a modification delaying the effective date * * * from the first day of the calendar quarter that begins at least 90 days after the date of enactment to the first day of the quarter beginning at least 180 days after such date.

[¶ 12,790] Act Sec. 1418. Law at ¶ 5547. CCH Explanation at ¶ 1286.

Excise Tax Simplification Provisions

House Committee Report

[*Beer withdrawn for embassy use*]

Simplification of excise taxes on distilled spirits, wine, and beer.—

* * *

Beer withdrawn for embassy use.—Subject to Treasury's regulatory authority, an exemption similar to that currently available for imported beer is provided for domestic beer.

* * *

Effective date.—* * * [The provision takes] effect on the first day of the calendar quarter that begins at least 90 days after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with a modification delaying the effective date * * * from the first day of the calendar quarter that begins at least 90 days after the date of enactment to the first day of the quarter beginning at least 180 days after such date.

[¶ 12,795] Act Sec. 1419. Law at ¶ 5547. CCH Explanation at ¶ 1285.

Excise Tax Simplification Provisions

House Committee Report

[*Beer withdrawn for destruction*]

Simplification of excise taxes on distilled spirits, wine, and beer.—

* * *

Beer withdrawn for destruction.—An exemption from tax is added for removals for destruction, subject to Treasury regulations.

* * *

Effective date.— * ** [The provision takes] effect on the first day of the calendar quarter that begins at least 90 days after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with a modification delaying the effective date * * * from the first day of the calendar quarter that begins at least 90 days after the date of enactment to the first day of the quarter beginning at least 180 days after such date.

[¶ 12,815] Act Sec. 1420. Law at ¶ 5549. CCH Explanation at ¶ 1287.

Excise Tax Simplification Provisions

House Committee Report

[*Drawback on exported beer*]

Simplification of excise taxes on distilled spirits, wine, and beer.—

* * *

Drawback on exported beer.—The certification requirement is relaxed to allow a drawback of tax paid if there is such proof of exportation as the Secretary may be regulations require.

* * *

Effective date.— * ** [The provision takes] effect on the first day of the calendar quarter that begins at least 90 days after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with a modification delaying the effective date * * * from the first day of the calendar quarter that begins at least 90 days after the date of enactment to the first day of the quarter beginning at least 180 days after such date.

[¶ 12,820] Act Sec. 1421. Law at ¶ 5569. CCH Explanation at ¶ 1288.

Excise Tax Simplification Provisions

House Committee Report

[*Bulk transfers of imported beer*]

Simplification of excise taxes on distilled spirits, wine, and beer.—

* * *

Imported beer transferred in bulk to brewery * *.*—Subject to Treasury regulations, beer imported in bulk may be withdrawn from customs custody and transferred in bulk to a brewery without payment of tax. The proprietor of the brewery to which the beer is transferred or of the winery to which the wine is transferred will be liable for the tax imposed on the withdrawal from customs custody and the importer will be relieved of liability.

Effective date.— * ** [The provision takes] effect on the first day of the calendar quarter that begins at least 90 days after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with a modification delaying the ef-

fective date * * * from the first day of the calendar quarter that begins at least 90 days after the date of enactment to the first day of the quarter beginning at least 180 days after such date.

[¶ 12,825] Act Sec. 1422. Law at ¶ 5563. CCH Explanation at ¶ 1282.

Excise Tax Simplification Provisions

House Committee Report

[*Bulk transfers of imported wine*]

Simplification of excise taxes on distilled spirits, wine, and beer.—

* * *

* * * *[I]mported wine transferred in bulk to wineries.—* * * * [T]he winery to which the wine is transferred will be liable for the tax imposed on the withdrawal from customs custody and the importer will be relieved of liability.

Effective date.— * * * [The provision takes] effect on the first day of the calendar quarter that begins at least 90 days after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with a modification delaying the effective date * * * from the first day of the calendar quarter that begins at least 90 days after the date of enactment to the first day of the quarter beginning at least 180 days after such date.

[¶ 12,845] Act Sec. 1431. Law at ¶ 5499. CCH Explanation at ¶ 1290.

Excise Tax Simplification Provisions

House Committee Report

[*Exemption from registration requirements*]

Authority for Internal Revenue Service to grant exemptions from excise tax registration requirements.—The IRS is authorized to waive the registration requirement for purchasers and second purchasers in all cases.

Effective date.—The provision applies to sales made pursuant to waivers issued after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,850] Act Sec. 1432. Law at ¶ 5475, 5509, 5510, 5511, 5512, 5513, 5515, 5517 and 5519. CCH Explanation at ¶ 1291.

Excise Tax Simplification Provisions

House Committee Report

[*Repeal expired provisions*]

Repeal of excise tax deadwood provisions.—[The Code includes a provision relating to a temporary reduction in the tax on piggyback trailers sold before July 18, 1985, and provisions relating to the tax on the removal of hard minerals from the deep seabed before June 28, 1990.]

[An excise tax is imposed on the sale or use by the manufacturer or importer of certain ozone-depleting chemicals (sec. 4681). The amount of the tax generally is determined by multiplying the base tax amount applicable for the calendar year by an ozone-depleting factor assigned to each taxable chemical. The base tax amount was $5.80 per pound in 1996 and will increase by 45 cents per pound per year thereafter. The code contains provisions for special rates of tax applicable to years before 1996 (e.g., sec. 4282(g)(1), (2), (3), and (5)).]

These provisions are repealed, as "deadwood".

Effective date.—The provisions are effective on the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,855] Act Sec. 1433. Law at ¶ 5497. CCH Explanation at ¶ 1270.

Other Excise Tax Provisions

Senate Committee Report

[*Excise tax on arrows*]

Modifications to excise tax on certain arrows.—Under the bill, the current excise tax on arrows tax is replaced with a manufacturer's excise tax on the four component parts of the arrow: shafts, points, nocks, and vanes. The tax rate is increased to 12.4 percent of the value of each of these four components to offset the reduction in aggregate value subjected to tax compared to present-law valuation of the completed arrow.

Effective date.—The provision is be effective for arrow components sold after September 30, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 12,860] Act Sec. 1434. Law at ¶ 5477. CCH Explanation at ¶ 1233 and 1236.

Other Excise Tax Provisions

Senate Committee Report

[*Heavy highway vehicle retail excise tax*]

Modifications to heavy highway vehicle retail excise tax.—The bill makes two changes to the heavy vehicle excise tax:

(1) Clarification is provided that the 75-percent-of-value threshold applies in determining whether repairs to a wrecked vehicle constitute remanufacture; and

(2) The registration requirement currently applicable to certain sales of trucks, tractors, and trailers for resale is replaced with a certification requirement.

Effective date.—The provision is effective after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 12,870] Act Sec. 1435. Law at ¶ 5473 and 5503. CCH Explanation at ¶ 1221.

Other Excise Tax Provisions

Senate Committee Report

[*Skydiving flights*]

Treatment of skydiving flights as noncommercial aviation.—The bill specifies that flights which are exclusively dedicated to skydiving are taxed as noncommercial aviation flights, regardless of whether instruction is offered to any of the passengers.

Effective date.—The provision is effective for flights beginning after September 30, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 12,875] Act Sec. 1436. Law at ¶ 5667. CCH Explanation at ¶ 1227.

Other Excise Tax Provisions

Senate Committee Report

[*Aviation fuels sold by "fixed base operators"*]

Eliminate double taxation of certain aviation fuels sold to producers by "fixed base operators".—The bill will permit a refund of the tax previously paid on aviation fuel when a producer acquires the fuel, resells it, and pays tax on the second sale.

Effective date.—The provision is effective for fuel sold after September 30, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment, with a clarification that the provision applies to tax-paid fuel purchased by registered producers after September 30, 1997.

[¶ 12,915] Act Sec. 1441 and 1445. Law at ¶ 5065. CCH Explanation at ¶ 355.

Tax-Exempt Bond Provisions

House Committee Report

[*$100,000 limit on unspent proceeds*]

Repeal of $100,000 limitation on unspent proceeds under 1-year exception from rebate.—The $100,000 limit on proceeds that may remain unspent after six months for certain governmental and qualified 501(c)(3) bonds otherwise exempt from the rebate requirement is deleted. Thus, if at least 95 percent of the proceeds of these bonds is spent within six months after their issuance, and the remainder is spent within one year, the six-month exception is deemed to be satisfied.

Effective date.—The provision applies to bonds issued after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,920] Act Sec. 1442 and 1445. Law at ¶ 5065. CCH Explanation at ¶ 356.

Tax-Exempt Bond Provisions

House Committee Report

[*Earnings rebate: Construction bond rules*]

Exception from rebate for earnings on bona fide debt service fund under construction bond rules.—The bill exempts earnings on bond proceeds invested in bona fide debt service funds from the arbitrage rebate requirement and the penalty requirement of the 24-month exception if the spending requirements of that exception are otherwise satisfied.

Effective date.—The provision applies to bonds issued after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,925] Act Sec. 1443 and 1445. Law at ¶ 5065. CCH Explanation at ¶ 357.

Tax-Exempt Bond Provisions

House Committee Report

[*Debt service-based limitation*]

Repeal of debt service-based limitation on investment in certain nonpurpose investments.—The bill repeals the 150-percent of debt service yield restriction.

Effective date.—The provision applies to bonds issued after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,930] Act Sec. 1444 and 1445. Law at ¶ 5065. CCH Explanation at ¶ 358.

Tax-Exempt Bond Provisions

House Committee Report

[*Expired student loan bond provisions*]

Repeal of expired provisions relating to student loan bonds.—[Present law includes two special exceptions to the arbitrage rebate and pooled financing temporary period rules for certain qualified student loan bonds. These exceptions applied only to bonds issued before January 1, 1989.]

These special exceptions are deleted as "deadwood."

Effective date.—The provision applies to bonds issued after the date of enactment. It has no effect on bonds issued prior to the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,955] Act Sec. 1451. Law at ¶ 5683. CCH Explanation at ¶ 1025.

Tax Court Procedures

House Committee Report

[*Tax Court overpayment determinations*]

Overpayment determinations of Tax Court.—The bill clarifies that an order to refund an overpayment is appealable in the same manner as a decision of the Tax Court. The bill also clarifies that the Tax Court does not have jurisdiction over the validity or merits of the credits or offsets that reduce or eliminate the refund to which the taxpayer was otherwise entitled.

Effective date.—The provision is effective on the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 12,960] Act Sec. 1452. Law at ¶ 5733. CCH Explanation at ¶ 1028.

Tax Court Procedures

House Committee Report

[*Redetermination of interest*]

Redetermination of interest pursuant to motion.—The bill provides that a taxpayer must file a "motion" (rather than a "petition") to seek a redetermination of interest in the Tax Court.

Effective date.—The provision is effective on the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. In clarifying the Tax Court's jurisdiction over interest determinations, the conferees do not intend to limit any other remedies that taxpayers may currently have with respect to such determinations, including in particular refund proceedings relating solely to the amount of interest due.

[¶ 12,965] Act Sec. 1453. Law at ¶ 5717. CCH Explanation at ¶ 1034 and 1037.

Tax Court Procedures

House Committee Report

[*Litigation cost awards: Net worth requirement*]

Application of net worth requirement for awards of litigation costs.—The bill provides that the net worth limitations currently applicable to individuals also apply to estates and trusts. The bill also provides that individuals who file a joint tax return shall be treated as one individual for purposes of computing the net worth limitations. Consequently, the net worth of both spouses is aggregated for purposes of this computation. An exception to this rule is provided in the case of a spouse otherwise qualifying for innocent spouse relief.

Effective date.—The provision applies to proceedings commenced after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill with respect to estates and trusts. The Senate amendment provides that individuals who file a joint return are treated as separate individuals (resulting in a net worth limitation of $4,000,000 for individuals who file a joint return).

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment with respect to estates and trusts. The conference agreement follows the Senate amendment with respect to individuals.

[¶ 12,985] Act Sec. 1454. Law at ¶ 5681, 5715, 5721, 5723, 5725 and 5733. CCH Explanation is ¶ 1031.

Tax Court Procedures

House Committee Report

[*Tax Court jurisdiction: Employment status*]

Tax Court jurisdiction for determination of employment status.—The bill provides that, in connection with the audit of any person, if there is an actual controversy involving a determination by the IRS as part of an examination that (a) one or more individuals performing services for that person are employees of that person or (b) that person is not entitled to relief under section 530 of the Revenue Act of 1978, the Tax Court would have jurisdiction to determine whether the IRS is correct. For example, one way the IRS could make the required determination is through a mechanism similar to the employment tax early referral procedures.[150]

The bill provides for de novo review (rather than review of the administrative record). Assessment and collection of the tax would be suspended while the matter is pending in the Tax Court. Any determination by the Tax Court would have the force and effect of a decision of the Tax Court and would be reviewable as such; accordingly, it would be binding on the parties. Awards of costs and certain fees (pursuant to section 7430) would be available to eligible taxpayers with respect to Tax Court determinations pursuant to the bill. The bill also provides a number of procedural rules to incorporate this new jurisdiction within the existing procedures applicable in the Tax Court.

Effective date.—The provision takes effect on the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill, with technical modifications.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with additional technical modifications.

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[150] See Announcement 96-13 and Announcement 97-52.

[¶ 13,115] Act Sec. 1461. Law at ¶ 5695. CCH Explanation at ¶ 623.

Other Simplification Provisions

House Committee Report

[*Private foundations: Estimated payments*]

Due date for first quarter estimated tax payments by private foundations.—The bill amends section 6655(g)(3) to provide that a calendar-year foundation's first-quarter estimated tax payment is due on May 15th (which is the same day that its annual return, Form 990-PF, for the preceding year is due). As a result of the operation of present-law section 6655(I), fiscal-year foundations will be required to make their first-quarter estimated tax payment no later than the 15th day of the fifth month of their taxable year.

Effective date.—The provision applies to taxable years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 13,120] Act Sec. 1462. Law at ¶ 7045. CCH Explanation at ¶ 1132.

Other Simplification Provisions

House Committee Report (Related Non-Code Provision)

[*Withhold Commonwealth income taxes from Federal employees*]

Withholding of Commonwealth income taxes from wages of Federal employees.—The bill makes any Commonwealth eligible to enter into an agreement with the Secretary of the Treasury that would provide for income tax withholding from the wages of Federal employees.

Effective date.—The provision is effective January 1, 1998.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 13,125] Act Sec. 1463. Law at ¶ 5689. CCH Explanation at ¶ 1108.

Other Simplification Provisions

House Committee Report

[*Notices disregarded on large corporate underpayments*]

Certain notices disregarded under provision increasing interest rate on large corporate underpayments.—For purposes of determining the period to which the large corporate underpayment rate applies, any letter or notice is disregarded if the amount of the deficiency, proposed deficiency, assessment, or proposed assessment set forth in the letter or notice is not greater than $100,000 (determined by not taking into account any interest, penalties, or additions to tax).

Effective date.—The provision is effective for purposes of determining interest for periods after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 13,215] Act Sec. 1501. Law at ¶ 5133 and 5139. CCH Explanation at ¶ 729.

Pension Simplification

Senate Committee Report

[*Self-employed individuals: Matching contributions not elective deferrals*]

Matching contributions of self-employed individuals not treated as elective deferrals.—The bill provides that matching contributions for self-employed individuals are treated the same as matching contributions for employees, i.e., they are not treated as elective contributions and are not subject to the elective contribution limit.

Effective date.—The provision is effective for years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment, and clarifies that the provision does not apply to qualified matching contributions that are treated as elective contributions for purposes of satisfying the ADP test.

Effective date.—Same as the Senate amendment, except that the conference agreement provides that the provision is effective for years beginning after December 31, 1996, in the case of SIMPLE retirement plans.

[¶ 13,225] Act Sec. 1502. Law at ¶ 5131 and 7046. CCH Explanation at ¶ 703.

Pension Simplification

Senate Committee Report (Code and Related Non-Code Provisions)

[*Modify assignment or alienation prohibition*]

Modification of prohibition on assignment or alienation.—The bill permits a participant's benefit in a qualified plan to be reduced to satisfy liabilities of the participant to the plan due to (1) the participant being convicted of committing a crime involving the plan, (2) a civil judgment (or consent order or decree) entered by a court in an action brought in connection with a violation of the fiduciary provisions of ERISA, or (3) a settlement agreement between the Secretary of Labor or the Pension Benefit Guaranty Corporation and the participant in connection with a violation of the fiduciary provisions of ERISA. The court order establishing such liability must require that the participant's benefit in the plan be applied to satisfy the liability. If the participant is married at the time his or her benefit under the plan is offset to satisfy the liability, spousal consent to such offset is required unless the spouse is also required to pay an amount to the plan in the judgment, order, decree or settlement or the judgment, order, decree or settlement provides a 50-percent survivor annuity for the spouse. The bill will make the corresponding changes to ERISA.

Effective date.—The provision is effective for judgments, orders, and degrees issued, and settlement agreements entered into, on or after the date of enactment.

Conference Committee Report

The conference agreement follows the Senate amendment. The conference agreement clarifies that an offset is includible in income on the date of the offset.

[¶ 13,235] Act Sec. 1503. Law at ¶ 7049. CCH Explanation at ¶ 708.

Pension Simplification

Senate Committee Report (Related Non-Code Provision)

[*Eliminate plan paperwork burdens*]

Elimination of paperwork burdens on plans.—The bill eliminates the requirement that SPDs and SMMs be filed with the Secretary of Labor. Employers would be required to furnish these documents to the Secretary of Labor upon request. A civil penalty could be imposed by the Secretary of Labor on the plan administrator for failure to comply with such requests. The penalty would be up to $100 per day of failure, up to a maximum of $1,000 per request. No penalty would be imposed if the failure was due to matters reasonably outside the control of the plan administrator.

Effective date.—The provision is effective on the date of enactment.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 13,245] Act Sec. 1504. Law at ¶ 5135. CCH Explanation at ¶ 776.

Pension Simplification

Senate Committee Report

[*Conform Code Sec. 403(b) exclusion allowance to Code Sec. 415*]

Modification of section 403(b) exclusion allowance to conform to section 415 modifications.—The bill conforms the exclusion allowance to the way in which the section 415 limit is calculated by providing that includible compensation includes elective deferrals of the employee, and contributions made at the election of the employee to an unfunded deferred compensation plan of a tax-exempt or State or local government (a sec. 457 plan) or a cafeteria plan.

The bill directs the Secretary to revise the regulations regarding the exclusion allowance to reflect the fact that the overall limit on benefits and contributions is repealed. The revised regulations are to be effective for limitation years beginning after December 31, 1999.

Effective date.—The modification to the definition of includible compensation is effective for years beginning after December 31, 1997. The direction to the Secretary is effective on the date of enactment.

Conference Committee Report

The conference agreement follows the Senate amendment, with the clarification that the revised Treasury regulations are to be effective for years (rather than limitation years) beginning after December 31, 1999. In addition, the conference agreement clarifies that the revised regulations are to relate to the election to have the exclusion allowance determined under section 415.

[¶ 13,255] Act Sec. 1505. Law at ¶ 5131, 5135 and 5145. CCH Explanation at ¶ 758.

Miscellaneous Provisions—Pensions and Other Benefits

House Committee Report

[*Moratorium on nondiscrimination rules for governmental plans*]

Permanent moratorium on application of nondiscrimination rules to governmental plans.—The bill provides that governmental plans will be exempt from the nondiscrimination and minimum participation rules.

Effective date.—The provision is effective for taxable years beginning on and after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment and clarifies that the exemption from the nondiscrimination and participation rules includes exemption from the ACP and ADP tests. The conference agreement provides that a cash or deferred arrangement under a governmental plan is treated as a qualified cash or deferred arrangement even though the ADP test is not in fact satisfied. Thus, for example, elective contributions made by a government employer on behalf of an employee are not treated as distributed or made available to the employee (in accordance with section 402(e)(3) of the Code).

Effective date.—Same as the House bill and Senate amendment.

[¶ 13,265] Act Sec. 1506. Law at ¶ 5143, 5529 and 7052. CCH Explanation at ¶ 752.

Miscellaneous Provisions—Pensions and Other Benefits

House Committee Report (Code and Related Non-Code Provisions)

[*S corporation ESOPs*]

ESOPs maintained by S corporations.—The bill provides that ESOPs of S corporations may distribute cash to plan participants. In addition, the bill extends the exception to certain prohibited transactions rules to S corporations.

Effective date.—The provisions are effective for taxable years beginning after December 31, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill with respect to the provision that permits ESOPs of S corporations to distribute stock in certain cases.

The Senate amendment provides that the sale of stock by a shareholder employee of an S corporation is not a prohibited transaction under the Code or ERISA.

Effective date.—Same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment with respect to the provision permitting ESOPs maintained by S corporations to distribute employer securities in certain circumstances. The conference agreement follows the Senate amendment with respect to the provision relating to prohibited transaction rules, as modified. Under the conference agreement, the statutory exceptions do not fail to apply merely because a transaction involves the sale of employer securities to an ESOP maintained by an S corporation by a shareholder employee, a family member of the shareholder employee, or a corporation controlled by the shareholder employee. Thus, the statutory exemptions for such a transaction (including the exemption for a loan to the ESOP to acquire employer securities in connection with such a sale or a guarantee of such a loan) apply.

Effective date.—Same as the House bill and the Senate amendment.

[¶ 13,275] Act Sec. 1507. Law at ¶ 5525. CCH Explanation at ¶ 725.

Pension Simplification

Senate Committee Report

[*10-percent tax on nondeductible contributions*]

Modification of 10-percent tax on nondeductible contributions.—The bill adds an additional exception to the 10-percent excise tax on nondeductible contributions. Under the provision, the excise tax does not apply to contributions to one or more defined contribution plans that are not deductible because they exceed the combined plan deduction limit to the extent such contributions do not exceed the amount of the employer's matching contributions plus the elective deferral contributions to a section 401(k) plan.

Effective date.—The provision is effective with respect to taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 13,285] Act Sec. 1508. Law at ¶ 7055. CCH Explanation at ¶ 721.

Pension Simplification

Senate Committee Report (Related Non-Code Provision)

[*Plan funding requirements*]

Modify funding requirements for certain plans.—The bill modifies the minimum funding requirements in the case of certain plans. The bill applies in the case of plans that (1) were not required to pay a variable rate PBGC premium for the plan year beginning in 1996, (2) do not, in plan years beginning after 1995 and before 2009, merge with another plan (other than a plan sponsored by an employer that was a member of the controlled group of the employer in 1996), and (3) are sponsored by a company that is engaged primarily in the interurban or interstate passenger bus service.

The bill treats a plan to which it applies as having a funded current liability percentage of at least 90 percent for plan years beginning after 1996 and before 2005. For plan years beginning after 2004, the funded current liability percentage will be deemed to be at least 90 percent if the actual funded current liability percentage is at least as follows:

Plan year beginning in:	*Minimum percentage*
2005	86
2006	87
2007	88
2008	89
2009 and thereafter	90

If the funded current liability percentage falls below 85 percent for a plan year beginning before 2005, the rule described above still applies if contributions for any such year are made to the plan in an amount equal to the lesser of: (1) the amount necessary to bring the funded current liability percentage to 85 percent, or (2) the greater of (a) 2 percent of the plan's current liability as of the beginning of such plan year or (b) the amount necessary to bring the funded

current liability percentage to 80 percent as of the end of such plan year.

The relief from the minimum funding requirements applies for the plan year beginning in 2005, 2006, 2007, and 2008 only if contributions to the plan equal at least the expected increase in current liability due to benefits accruing during the plan year.

Effective date.—The provision is effective with respect to contributions due after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment.

Effective date.—The provision is effective with respect to plan years beginning after December 31, 1996.

[¶ 13,295] Act Sec. 1509. Law at ¶ 7058. CCH Explanation at ¶ 701.

Pension Simplification

Senate Committee Report (Related Non-Code Provision)

[*Qualified plans: Rollover contributions*]

Plans not disqualified merely by accepting rollover contributions.—The bill clarifies the circumstances under which a qualified plan could accept rollover contributions without jeopardizing its qualified status. Under the provision, if the trustee of the plan making the distribution notifies the recipient plan that the distributing plan is intended to be a qualified plan, the plan receiving the rollover will not be disqualified if the distributing plan was not in fact a qualified plan.

Effective date.—The provision is effective for rollover contributions made after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment, as modified. Under the conference agreement, the Secretary of the Treasury is directed to clarify that, under its regulations protecting plans from disqualification because they receive invalid rollover contributions, it is not necessary for a distributing plan to have a determination letter in order for the administrator of the receiving plan to reasonably conclude that a contribution is a valid rollover.

[¶ 13,315] Act Sec. 1510. Law at ¶ 7061. CCH Explanation at ¶ 710.

Pension Simplification

Senate Committee Report (Related Non-Code Provision)

[*Retirement plans: New technologies*]

New technologies in retirement plans.—The bill directs the Secretaries of the Treasury and Labor to each issue guidance facilitating the use of new technology for plan purposes. The guidance will be designed to (1) interpret the notice, election, consent, disclosure, and time requirements (and related recordkeeping requirements) under the Internal Revenue Code of 1986 ("IRC") and the Employee Retirement Income Security Act of 1974, as amended ("ERISA") relating to retirement plans as applied to the use of new technologies by plan sponsors and administrators while maintaining the protection of the rights of participants and beneficiaries, and (2) clarify the extent to which writing requirements under the IRC shall be interpreted to permit paperless transactions.

Effective date.—The provision is effective on the date of enactment and requires that the guidance be issued not later than December 31, 1998.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 13,335] Act Sec. 1521(a) and (b). Law at ¶ 5149 and 7064. CCH Explanation at ¶ 717.

Miscellaneous Provisions—Pensions and Other Benefits

Senate Committee Report (Code and Related Non-Code Provisions)

[*Full funding limit*]

Increase in full funding limit.—The bill increases the 150-percent of full funding limit as follows: 155 percent for plan years beginning in 1999 or 2000, 160 percent for plan years beginning in 2001 or 2002, 165 percent for plan years beginning in 2003 and 2004, and 170 percent for plan years beginning in 2005 and thereafter.

Effective date.—The provision is effective for plan years beginning after December 31, 1998.

Conference Committee Report

The conference agreement follows the Senate amendment * * *.

[¶ 13,340] Act Sec. 1521(c)(1). Law is at ¶ 5149. CCH Explanation is at ¶ 719.

Miscellaneous Provisions—Pensions and Other Benefits

Conference Committee Report

[*Code Sec. 412(b)(2) amortization*]

Increase in full funding limit.—

Senate [Floor] Amendment.— * * *

In addition, under the provision, amounts that cannot be contributed due to the current liability full funding limit are amortized over 20 years. Amounts that could not be contributed because of such full funding limit and that have not been amortized as of the last day of the plan year beginning in 1998 are amortized over this 20-year period.

Effective date.—Plan years beginning after December 31, 1998.

Conference Agreement

The conference agreement follows the Senate amendment, with the modification that, with respect to amortization bases remaining at the end of the 1998 plan year, the 20-year amortization period is reduced by the number of years since the amortization base had been established. The conference agreement also clarifies that no amortization is required with respect to funding methods that do not provide for amortization bases.

[¶ 13,345] Act Sec. 1522(a)(1). Law at ¶ 5151. CCH Explanation at ¶ 768.

Miscellaneous Provisions—Pensions

Senate Committee Report

[*Discrimination testing of non-church plans*]

Exclusion of ministers from discrimination testing of certain non-church retirement plans.—The bill provides that if a minister is employed by an organization other than a church and the organization is not otherwise participating in the church plan then, the minister does not have to be included as an employee under the retirement plan of the organization for purposes of the nondiscrimination rules.

Effective date.—The provision is effective for years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment.

[¶ 13,347] Act Sec. 1522(a)(2). Law at ¶ 5151. CCH Explanation at ¶ 766.

Miscellaneous Provisions—Pensions

Senate Committee Report

[*Contributions to church plans*]

Contributions on behalf of a minister to a church plan.—The bill provides that in the case of a contribution made on behalf of a minister who is self-employed to a church plan, the contribution will be excludable from the income of the minister to the extent that the contribution would be excludable if the minister was an employee of a

church and the contribution was made to the plan.

Effective date.—The provision is effective for years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment. The provision does not alter present law under which amounts contributed for a minister in connection with section 403(b), either by the minister's actual employer or by any church or convention or association of churches that is treated as the minister's employer under section 414(e), are excluded from the minister's income, and amounts contributed in accordance with section 403(b) by the minister (whether the minister is an employee or is self employed) are deductible by the minister as provided in section 404 taking into account the other special rules of section 414(e).

[¶ 13,355] Act Sec. 1523. Law at ¶ 5173. CCH Explanation at ¶ 755.

Miscellaneous Provisions—Pensions

Senate Committee Report

[*S Corporation ESOPs: UBIT application*]

Repeal application of UBIT to ESOPs of S corporations.—The bill repeals the provision treating items of income or loss of an S corporation as unrelated business taxable income in the case of an employee stock ownership plan that is an S corporation shareholder.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment, and clarifies that the repeal of the provision treating items of income or loss of an S corporation as unrelated business taxable income applies only with respect to employer securities held by an employee stock ownership plan (as defined in section 4975(e)(7) of the Code) maintained by an S corporation.

[¶ 13,365] Act Sec. 1524. Law at ¶ 7067. CCH Explanation at ¶ 727.

Miscellaneous Provisions—Pensions and Other Benefits

Conference Committee Report (Related Non-Code Provision)

[*401(k) plan investments: Diversification*]

Diversification in section 401(k) plan investments.—

Senate [Floor] Amendment.—The Senate amendment provides that the term "eligible individual account plan" does not include the portion of a plan that consists of elective deferrals (and earnings on the elective deferrals) made under section 401(k) if elective deferrals equal to more than 1 percent of a participant's compensation are required to be invested in employer securities at the direction of a person other than the participant. Such portion of the plan is treated as a separate plan subject to the 10-percent limitation on investment in employer securities and real property.

The Senate amendment does not apply to an individual account plan if the value of the assets of all individual account plans maintained by the employer does not exceed 10 percent of the value of the assets of all pension plans maintained by the employer. The Senate amendment does not apply to an employee stock ownership plan as defined in sections 409(a) and 4975(e)(7) of the Internal Revenue Code.

Effective date.—The provision is effective with respect to employer securities and employer real property acquired after the beginning of the first plan year beginning after the 90th day after the date of enactment. The provision does not apply to employer securities or real property acquired pursuant to a binding written contract to acquire such securities or real property in effect on the date of enactment and at all times thereafter.

Conference agreement.—The conference agreement follows the Senate amendment, with modifications. The conference agreement clarifies that the provision applies if elective deferrals equal to more than 1 percent of an employee's eligible compensation are required to be invested in employer securities and employer real property. Eligible compensation is compensation that is eligible to be deferred. As under the Senate amendment, if the 1 percent threshold is exceeded, then the portion of the plan that consists of elective deferrals (and earnings thereon) is still treated as an individual account plan as long as elective deferrals (and earnings thereon) are not required to be invested in employer securities and employer real property.

The conference agreement provides that multiemployer plans are not taken into account in determining whether the value of the assets of all individual account plans maintained by the em-

ployer does not exceed 10 percent of the value of the assets of all pension plans maintained by the employer. The conference agreement provides that the provision does not apply to an employee stock ownership plan as defined in section 4975(e)(7) of the Internal Revenue Code.

Effective date.—Under the conference agreement, the provision is effective with respect to elective deferrals in plan years beginning after December 31, 1998 (and earnings thereon). This provision does not apply with respect to earnings on elective deferrals for years beginning before January 1, 1999.

[¶ 13,375] Act Sec. 1525. Law at ¶ 5131. CCH Explanation at ¶ 731.

Miscellaneous Provisions—Pensions and Other Benefits

House Committee Report

[*Irrigation and drainage entity plans*]

Cash or deferred arrangements for irrigation and drainage entities.—Under the bill, mutual irrigation or ditch companies and districts organized under the laws of a State as a municipal corporation for the purpose of irrigation, water conservation or drainage (or a national association of such organizations) are permitted to maintain qualified cash or deferred arrangements, even if the company or district is a State or local government organization.

Effective date.—The provision is effective with respect to years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 13,385] Act Sec. 1526. Law at ¶ 5153. CCH Explanation at ¶ 760.

Miscellaneous Provisions—Pensions and Other Benefits

House Committee Report

[*Portability of permissive service credit*]

Portability of permissive service credit under governmental pension plans.—Under the bill, in applying the defined benefit pension plan limit, the annual benefit under a State or local governmental plan includes the accrued benefit derived from contributions to purchase permissive service credit. Such contributions are not taken into account in determining annual additions.

Permissive service credit means credit for a period of service recognized by the governmental plan if the employee contributes to the plan an amount (as determined by the plan) which does not exceed the amount necessary to fund the accrued benefit attributable to such period of service.

The bill does not affect the treatment of "pick up" contributions.

Effective date.—The provision is effective with respect to years beginning after December 31, 1997.

Conference Committee Report

The conference agreement follows the House bill, with modifications. Under the conference agreement, contributions by a participant in a State or local governmental plan to purchase permissive service credits are subject to one of two limits. Either (1) the accrued benefit derived from all contributions to purchase permissive service credit must be taken into account in determining whether the defined benefit pension plan limit is satisfied, or (2) all such contributions must be taken into account in determining whether the $30,000 limit on annual additions is met for the year (taking into account any other annual additions of the participant). Under the first alternative, a plan will not fail to satisfy the reduced defined benefit pension plan limit that applies in the case of early retirement due to the accrued benefit derived from the purchase of permissive service credits. These limits may be applied on a participant-by-participant basis. That is, contributions to purchase permissive service credits by all participants in the same plan do not have to satisfy the same limit.

Under the conference agreement, permissive service credit is defined as under the House bill. Thus, it is credit for a period of service that is recognized by the governmental plan only if the employee voluntarily contributes to the plan an amount (as determined by the plan) which does not exceed the amount necessary to fund the benefit attributable to the period of service and which is in addition to the regular employee contributions, if any, under the plan. Section 415 is violated if more than 5 years of permissive service

credit is purchased for "nonqualified service". In addition, section 415 is violated if nonqualified service is taken into account for an employee who has less than 5 years of participation under the plan. Nonqualified service is service other than service (1) as a Federal, State, or local government employee, (2) as an employee of an association representing Federal, State or local government employees, (3) as an employee of an educational institution which provides elementary or secondary education, or (4) for military service. Service under (1), (2) or (3) is not qualified if it enables a participant to receive a retirement benefit for the same service under more than one plan.

The conference agreement provides that in the case of any repayment of contributions and earnings to a governmental plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State) any such repayment shall not be taken into account for purposes of section 415 and service credit obtained as a result of the repayment shall not be considered permissive service credit.

The provision is not intended to affect the application of "pick up" contributions to purchase permissive service credit or the treatment of pick up contributions under section 415. The provision does not apply to purchases of service credit for qualified military service under the rules relating to veterans' reemployment rights (sec. 414(u)).

Effective date.—In general, the conference agreement is effective with respect to contributions to purchase permissive service credits made in years beginning after December 31, 1997.

The conference agreement provides a transition rule for plans that provided for the purchase of permissive service credit prior to enactment of this Act. Under this rule, the defined contribution limits will not reduce the amount of permissive service credit of an eligible participant allowed under the terms of the plan as in effect on the date of enactment. For this purpose an eligible participant is an individual who first became a participant in the plan before the first plan year beginning after the last day of the calendar year in which the next regular session (following the date of the enactment of this Act) of the governing body with authority to amend the plan ends.

[¶ 13,395] Act Sec. 1527. Law at ¶ 5153. CCH Explanation at ¶ 764.

Miscellaneous Provisions—Pensions and Other Benefits

Conference Committee Report

[*Defined benefit plan for police and fire employees*]

Removal of dollar limitation on benefit payments from a defined benefit plan for police and fire employees.—

Senate [Floor] Amendment.—The dollar limit on defined benefit plans does not apply to individuals who receive the special rule for certain police and fire department employees under present law.

Effective date.—Years beginning after December 31, 1996.

Conference Agreement.—The conference agreement follows the Senate amendment, with the clarification that the exception from the dollar limit for police and fire department employees only applies to the reduction for early retirement benefits. Thus, the defined benefit plan dollar limit continues to apply, but is not reduced in the case of early retirement. As under present law, the dollar limit is increased for such employees if benefits begin after age 65.

Effective date.—Same as the Senate amendment.

[¶ 13,415] Act Sec. 1528. Law at ¶ 5043. CCH Explanation at ¶ 137.

Other Miscellaneous Provisions

House Committee Report

[*Death of police officer in line of duty*]

Exemption from tax upon death of a police officer in the line of duty.—The bill generally provides that an amount paid as a survivor annuity on account of the death of a law enforcement officer who is killed in the line of duty will be excludable from income to the extent the survivor annuity is attributable to the officer's service as a law enforcement officer. The survivor annuity must be provided under a governmental plan to the surviving spouse (or former spouse) of the law enforcement officer or to a child of the officer.

Effective date.—The provision applies to amounts received in taxable years beginning after December 31, 1996, with respect to individuals dying after that date.

Conference Committee Report

Senate [Floor] Amendment.—The Senate amendment is the same as the House bill except that the provision applies to public safety officers killed in the line of duty. Public safety officers include law enforcement officers, firefighters, rescue squad or ambulance crew.

Conference Agreement.—The conference agreement follows the Senate amendment. The conference agreement clarifies that the provision does not apply with respect to the death of a public safety officer if it is determined by the appropriate supervising authority that (1) the death was caused by the intentional misconduct of the officer or by the officers intention to bring about the death, (2) the officer was voluntarily intoxicated at the time of death, (3) the officer was performing his or her duties in a grossly negligent manner at the time of death, or (4) the actions of the individual to whom payment is to be made were a substantial contributing factor to the death of the officer.

[¶ 13,425] Act Sec. 1529. Law at ¶ 7070. CCH Explanation at ¶ 135.

Miscellaneous Provisions—Pensions and Other Benefits

House Committee Report (Related Non-Code Provision)

[*Disability payments: Public safety employees*]

Treatment of certain disability payments to public safety employees.—Under the bill, certain payments made on behalf of full-time employees of any police or fire department organized and operated by a State (or any political subdivision, agency, or instrumentality thereof) are excludable from income. The bill applies to payments made on account of heart disease or hypertension of the employee and that were received in 1989, 1990, 1991 pursuant to a State law as amended on May 19, 1992, which irrebuttably presumed that heart disease and hypertension are work-related illnesses, but only for employees separating from service before July 1, 1992.

The bill provides that claims for refund or credit for overpayment of tax resulting from the provision could be filed up to 1 year after the date of enactment, without regard to the otherwise applicable statute of limitations.

Effective date.—The provision is effective on the date of enactment.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 13,435] Act Sec. 1530. Law at ¶ 5131, 5137, 5153, 5203, 5207, 5433, 5435, 5521, 5529, 5531 and 5533. CCH Explanation at ¶ 284.

Miscellaneous Provisions—Pensions and Other Benefits

House Committee Report

[*Gratuitous transfers for employees' benefit*]

Gratuitous transfers for the benefit of employees.—

In general.—The bill permits certain limited transfers of qualified employer securities by charitable remainder trusts to ESOPs without adversely affecting the status of the charitable remainder trusts under Code section 664. As a result, the bill provides that a qualified gratuitous transfer of employer securities to an ESOP is deductible from the gross estate of a decedent under Code section 2055 to the extent of the present value of the remainder interest. In addition, an ESOP will not fail to be a qualified plan because it complies with the requirements with respect to a qualified gratuitous transfer.

Qualified gratuitous transfer.—In order for a transfer of securities to be a "qualified gratuitous transfer," the following requirements must be satisfied: (1) the securities transferred must previously have passed from the decedent to a charitable remainder trust; (2) at the time of the transfer to the ESOP, family members of the decedent own (directly or indirectly) no more than 10 percent of the value of the outstanding stock of the company; (3) immediately after the transfer to the ESOP, the ESOP owns at least 60 percent [54] of the value of outstanding stock of the company; and (4) the plan meets certain requirements. In order to prevent erosion of the 60-percent ownership requirements, an excise tax is imposed on the employer maintaining the ESOP

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[54] The 60-percent requirement is determined assuming that outstanding options have been exercised.

with respect to certain dispositions of the transferred stock within 3 years of the transfer.

The provision applies in cases in which the ESOP was in existence on August 1, 1996, and the decedent dies on or before December 31, 1998. The provision does not fail to apply merely because the ESOP is amended after August 1, 1996, for example, in order to conform to the requirements of the provision.

Plan requirements.—In order for a transfer to qualify as a gratuitous transfer, the ESOP must contain certain provisions. First, the plan must provide that plan participants are entitled to direct the manner in which stock transferred are to be voted (with respect to all matters). Transferred securities that have not yet been allocated to participants must be voted by a trustee that is not a 5-percent owner of the company or a family member of the decedent.

Second, the plan must provide that participants have the right to receive distributions in the form of stock and that the participant can require the employer to repurchase any shares distributed under a fair valuation formula. For this purpose, a valuation formula is not considered fair if it takes into account a discount for minority interests.

Finally, the plan must provide that, if the plan is terminated before all the transferred stock has been allocated, the remaining stock is to be transferred to one or more charitable organizations. The employer is subject to an excise tax designed to recapture the estate taxes that would have been due had the transfer to the ESOP not occurred if the plan is terminated and any unallocated shares are not transferred to charitable organizations.

Treatment of transferred stock and allocation rules.—No deduction is permitted under section 404 of the Code with respect to securities transferred from the charitable remainder trust. The nondiscrimination requirements (sec. 401(a)(4)) normally applicable to qualified plans must be satisfied with respect to the securities transferred. The ESOP is required to treat the securities transferred as employer securities, except for purposes of determining the amount of deductible contributions to the plan otherwise permitted by the employer. The ESOP is required to allocate the transferred securities up to the limit on contributions and benefits (sec. 415) after allocating any other employer contributions for the year; any transferred securities that can not be allocated because of the section 415 limits would be held in a suspense account and allocated in the same manner in subsequent years. Transferred securities are not taken into account in determining whether any other contributions satisfy the section 415 limit. Further, securities transferred to an ESOP by a charitable remainder trust cannot be allocated to the account of (1) any family member of the decedent, or (2) any employee owning more than 5 percent of any class of outstanding stock of the corporation issuing the securities (or a member of a controlled group of corporations) or the total value of any class of outstanding stock of any such corporation. The employer is subject to an excise tax if impermissible allocations are made.

Definition of qualified employer securities.—Qualified employer securities include only employer securities (within the meaning of sec. 409(l) of the Code), which are issued by a domestic corporation that has no outstanding stock that is readily tradable on an established securities market and that has only one class of stock.

Effective date.—The bill applies to transfers made to trusts to, or for the use of, an ESOP after the date of enactment.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 13,455] Act Sec. 1531. Law at ¶ 5537, 5759, 5763, 5765, 5767, 5769 and 5771. CCH Explanation at ¶ 865.

Pension and Employee Benefit Provisions

Conference Committee Report

[*Newborns' and mothers' health protection; Mental parity*]

Newborns' and mothers' health protection; mental parity.—The conference agreement incorporates into the Internal Revenue Code the provisions of the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996 relating to group health plans. Failures to comply with such provisions are subject to the present-law excise tax applicable to failures to comply with present-law group health plan requirements.

Effective date.—The provisions are effective with respect to plan years beginning on or after January 1, 1998.

[¶ 13,465] Act Sec. 1532. Law at ¶ 5761. CCH Explanation at ¶ 867.

Pension and Employee Benefit Provisions

Conference Committee Report

[*Church plans: Discrimination based on health status*]

Church plan exception to prohibition on discrimination against individuals based on health status.—The conference agreement provides that certain church plans are not treated as violating the nondiscrimination requirement merely because the plan requires evidence of good health in order for an individual to enroll in the plan for (1) individuals who are employees of employers with 10 or fewer and for self-employed individuals or (2) any individual who enrolls after the first 90 days of eligibility under the plan. The provision applies to a church plan for a year if the plan included such provisions requiring evidence of good health on July 15, 1997, and at all times thereafter before the beginning of the year.

Effective date.—The provision is effective as if included in HIPAA.

[¶ 13,485] Act Sec. 1541. Law at ¶ 7072. CCH Explanation at ¶ 790.

Pension Simplification

Conference Committee Report (Related Non-Code Provision)

[*Adoption of plan amendments*]

Date for adoption of plan amendments.—The conference agreement provides that any amendments to a plan or annuity contract required to be made by the Act are not required to be made before the first day of the first plan year beginning on or after January 1, 1999. In the case of a governmental plan, the date for amendments is extended to the first plan year beginning on or after January 1, 2001. The conference agreement also provides that if an amendment is made pursuant to the Act (whether or not the amendment is required) before the date for required plan amendments, the plan or contract is operated in a manner consistent with the amendment during a period and the amendment is effective retroactively to such period (1) the plan or contract will not fail to be treated as operated in accordance with its terms for such period merely because it is operated in a manner consistent with the amendment, and (2) the plan will not fail to meet the anti-cutback provisions applicable to qualified retirement plans by reason of such a plan amendment.

[¶ 13,520] Act Sec. 1601(a)(1). Law at ¶ 5609. CCH Explanation at ¶ 1061.

Technical Corrections: 1996 Small Business Job Protection Act—Small Business-Related Provisions

House Committee Report

[*Fish purchases: Information returns*]

Returns relating to purchases of fish.—Every person filing an informational return relating to the purchase of fish must furnish a statement showing the phone number of the person filing the return, as well as such person's name, address and the amount shown on the return, to each person whose name is required to be disclosed on the return.

[*Effective date.*—This provision is effective for payments made after December 31, 1997.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,525] Act Sec. 1601(c)(1). Law at ¶ 5375. CCH Explanation at ¶ 473.

Technical Corrections: 1996 Small Business Job Protection Act—Small Business-Related Provisions

House Committee Report

[*Charitable remainder trusts not eligible ESBTs*]

Charitable remainders trusts not eligible to be electing small business trusts.—The provision clarifies that charitable remainder annuity trusts and charitable remainder unitrusts may not be electing small business trusts.

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,530] Act Sec. 1601(c)(2). Law at ¶ 7076. CCH Explanation at ¶ 475.

Technical Corrections: 1996 Small Business Job Protection Act—Small Business-Related Provisions

House Committee Report (Related Non-Code Provision)

[*Post-termination transition: Effective date*]

Clarify the effective date for post-termination transition period provision.—The technical correction clarifies that the effective date for the Small Business Act provision affecting the post-termination transition period is for determinations after December 31, 1996, not for determinations with respect to taxable years beginning after December 31, 1996. However, in no event will the post-termination transition period expanded by the Small Business Act end before the end of the 120-day period beginning after the date of enactment of this Act.

[*Effective date.*—This provision is effective for determinations made after December 31, 1996, and for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,535] Act Sec. 1601(c)(3). Law at ¶ 5375. CCH Explanation at ¶ 477.

Technical Corrections: 1996 Small Business Job Protection Act—Small Business-Related Provisions

House Committee Report

[*QSSSs*]

Treatment of qualified subchapter S subsidiaries.—The technical correction provides that the Secretary of the Treasury may provide, by regulations, instances where the separate corporate existence of a qualified subchapter S subsidiary may be taken into account for purposes of the Code. Thus, if an S corporation owns 100 percent of the stock of a bank (as defined in sec. 581) and elects to treat the bank as a qualified subchapter S subsidiary, it is expected that Treasury regulations would treat the bank as a separate legal entity for purposes of those Code provisions that apply specifically to banks (e.g., sec. 582).

Treasury regulations also may provide exceptions to the general rule that the qualified subchapter S subsidiary election is treated as a deemed section 332 liquidation of the subsidiary in appropriate cases. In addition, if the effect of a qualified subchapter S subsidiary election is to invalidate an election to join in the filing of a consolidated return for a group of subsidiaries that formerly joined in such filing, Treasury regulations may provide guidance as to the consolidated return effects of the S election.

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,555] Act Sec. 1601(d)(1)(A). Law at ¶ 5139. CCH Explanation at ¶ 740.

Technical Corrections: 1996 Small Business Job Protection Act—Pension Provisions

House Committee Report

[*SIMPLE plans: IRA reporting*]

Reporting requirements for SIMPLE IRAs.—The bill conforms the time for providing reports for SIMPLE IRAs to that for IRA reports generally. Thus, the bill would provide that the report required to be furnished to the individual under a SIMPLE IRA would be provided within 31 days after each calendar year.

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,560] Act Sec. 1601(d)(1)(B). Law at ¶ 5139. CCH Explanation at ¶ 785.

Technical Corrections: 1996 Small Business Job Protection Act—Pension Provisions

House Committee Report

[*SARSEPs*]

Salary reduction simplified employee pensions ("SARSEPS").—The bill amends Code section 408(k)(6) to clarify that new employees of an employer hired after December 31, 1996, may participate in a SARSEP of an employer established before January 1, 1997.

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,565] Act Sec. 1601(d)(1)(C). Law at ¶ 5139 and 5703. CCH Explanation at ¶ 741.

Technical Corrections: 1996 Small Business Job Protection Act—Pension Provisions

House Committee Report

[*SIMPLE plans: IRA notification*]

Notification requirment for SIMPLE IRAs.—The bill provides that issuers of annuities for SIMPLE IRAs have the same reporting requirements as SIMPLE IRA trustees.

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,570] Act Sec. 1601(d)(1)(D). Law at ¶ 5139. CCH Explanation at ¶ 735.

Technical Corrections: 1996 Small Business Job Protection Act—Pension Provisions

House Committee Report

[*SIMPLE plans: IRA dollar limit*]

Maximum dollar limitation for SIMPLE IRAs.—The bill provides that in the case of a SIMPLE IRA, the $2,000 maximum limitation applicable to IRAs is increased to the limitations in effect for contributions made under a qualified salary reduction arrangement. This includes employee elective contributions and required employer contributions.

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,580] Act Sec. 1601(d)(1)(E). Law at ¶ 5139. CCH Explanation at ¶ 737.

Technical Corrections: 1996 Small Business Job Protection Act—Pension Provisions

House Committee Report

[*SIMPLE plans: IRA exclusive plan requirement: Noncollectively bargained employees*]

Application of exclusive plan requirement for SIMPLE IRAs to noncollectively bargained employees.—The bill provides that an employer who maintains a plan for collectively bargained employees is permitted to maintain a SIMPLE IRA for noncollectively bargained employees.

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,590] Act Sec. 1601(d)(1)(F). Law at ¶ 5139. CCH Explanation at ¶ 739.

Technical Corrections: 1996 Small Business Job Protection Act—Pension Provisions

House Committee Report

[*SIMPLE plans: IRA exclusive plan requirement: Mergers and acquisitions*]

Application of exclusive plan requirement for SIMPLE IRAs in the case of mergers and acquisitions.—The bill provides that if an employer maintains a qualified plan and a SIMPLE IRA in the same year due to an acquisition, disposition or similar transaction the SIMPLE IRA is treated as a qualified salary reduction arrangement for the year of the transaction and the following calendar year.

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,595] Act Sec. 1601(d)(2)(A). Law at ¶ 5131. CCH Explanation at ¶ 747.

Technical Corrections: 1996 Small Business Job Protection Act—Pension Provisions

House Committee Report

[*SIMPLE plans: Top-heavy exemption*]

Top-heavy exemption for SIMPLE 401(k) arrangements.—The bill provides that the top-heavy exemption applies to a plan which permits only contributions required to satisfy the SIMPLE 401(k) requirements.

[*Effective date.*—This provision is effective for plan years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,615] Act Sec. 1601(d)(2)(B). Law at ¶ 5131. CCH Explanation at ¶ 745.

Technical Corrections: 1996 Small Business Job Protection Act—Pension Provisions

House Committee Report

[*SIMPLE plans: Cost of living adjustments*]

Cost of living adjustments for SIMPLE 401(k) arrangements.—The bill provides that the $6,000 limit on elective deferrals under a SIMPLE 401(k) arrangement will be adjusted at the same time and in the same manner as for SIMPLE IRAs.

[*Effective date.*—This provision is effective for plan years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,620] Act Sec. 1601(d)(2)(C). Law at ¶ 5137. CCH Explanation at ¶ 743.

Technical Corrections: 1996 Small Business Job Protection Act—Pension Provisions

House Committee Report

[*SIMPLE plans: Employer deduction*]

Employer deduction for SIMPLE 401(k) arrangements.—The bill provides that to the extent that contributions paid by an employer to a SIMPLE 401(k) arrangement satisfy the contribution requirements of section 401(k)(11)(B), such contributions is deductible by the employer for the taxable year.

[*Effective date.*—This provision is effective for plan years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,625] Act Sec. 1601(d)(2)(D). Law at ¶ 5131. CCH Explanation at ¶ 749.

Technical Corrections: 1996 Small Business Job Protection Act—Pension Provisions

House Committee Report

[*SIMPLE plans: 401(k) notification and election*]

Notification and election periods for SIMPLE 401(k) arrangements.—The bill extends the employer notice and employee election requirements of SIMPLE IRAs to SIMPLE 401(k) arrangements.

Effective date.—The bill is effective with respect to calendar years beginning after the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,630] Act Sec. 1601(d)(4). Law at ¶ 7076. CCH Explanation at ¶ 779.

Technical Corrections: 1996 Small Business Job Protection Act—Pension Provisions

House Committee Report (Related Non-Code Provision)

[*401(k) plans: Indian tribal governments*]

Treatment of Indian tribal governments under section 403(b).—The bill clarifies that an employee participating in a 403(b) annuity contract of the Indian tribal government would be permitted to roll over amounts from such contract to a section 401(k) plan maintained by the Indian tribal government whether or not the annuity contract is terminated.

[*Effective date.*—This provision is effective August 20, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,635] Act Sec. 1601(d)(5). Law at ¶ 7076.

Technical Corrections: 1996 Small Business Job Protection Act—Pension Provisions

Conference Committee Report (Related Non-Code Provision)

[*ERISA*]

* * * The conference agreement amends section 205(c) of the Employee Retirement Income Security Act (as amended by the Small Business Job Protection Act of 1996) to clarify that the reference to "the Secretary" is to the Secretary of the Treasury.

* * *

[¶ 13,640] Act Sec. 1601(d)(6). Law at ¶ 5135 and 5151.

Technical Corrections: 1996 Small Business Job Protection Act—Pension Provisions

Conference Committee Report

[*Church plans*]

Senate Amendment.—The Senate amendment * * * makes clarifications to the provisions relating to church plans included in the Small Business Job Protection Act of 1996.

Conference Agreement.—The conference agreement follows * * * the Senate amendment. Thus, the conference agreement contains * * * the provisions in the Senate amendment relating to church plans.

* * *

[¶ 13,645] Act Sec. 1601(e). Law at ¶ 5301. CCH Explanation at ¶ 938.

Technical Corrections: 1996 Small Business Job Protection Act—Foreign Provisions

House Committee Report

[*CFC earnings*]

Measurement of earnings of controlled foreign corporations.—The technical correction clarifies that accumulated earnings and profits of a CFC taken into account for purposes of determining the CFC's earnings invested in United States property do not include current earnings (which are taken into account separately). A similar technical correction to the definition of earnings for purposes of prior-law section 956A (relating to a CFC's earnings invested in excess passive assets) was enacted with the Small Business Job Protection Act of 1996 (section 1703(i)(2)).

[*Effective date.*—This provision is effective for tax years of foreign corporations beginning after December 31, 1996, and for tax years of U.S. shareholders within which or with which such tax years of foreign corporations end.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,650] Act Sec. 1601(f)(2). Law at ¶ 5753. CCH Explanation at ¶ 1292.

Technical Corrections: 1996 Small Business Job Protection Act—Excise Tax Provisions

House Committee Report

[*Diesel fuel tax advance refunds*]

Repeal "deadwood" provisions relating to previous allowance of advance refunds of diesel fuel tax.—The bill repeals the Highway Trust Fund provisions relating to the diesel fuel advance refunds, as deadwood.

[*Effective date.*—This provision is effective for vehicles purchased after August 20, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,655] Act Sec. 1601(f)(3). Law at ¶ 5469. CCH Explanation at ¶ 1242.

Technical Corrections: 1996 Small Business Job Protection Act—Excise Tax Provisions

House Committee Report

[*Luxury automobile excise tax*]

Phaseout and expiration of excise tax on luxury automobiles.—The bill clarifies that the phased reduction in luxury excise tax rates and the expiration date of December 31, 2002, enacted as part of the Small Business Act, apply both for the tax imposed on the purchase of new automobiles under section 4001 and for the tax imposed for the separate purchase of vehicles and parts and accessories therefor under section 4003.

[*Effective date.*—This provision is effective for sales occurring on or after August 27, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

In addition, the conference agreement makes the following additions, modifications, and clarifications relating to technical correction provisions.

* * *

(3) The conference agreement provides that the technical correction provisions clarifying the

phased reduction in luxury excise tax rates for automobiles will be effective for sales after the date of enactment of this Act.

* * *

[¶ 13,660] Act Sec. 1601(f)(4). Law at ¶ 5473, 5487 and 5503. CCH Explanation at ¶ 1206.

Technical Corrections: 1996 Small Business Job Protection Act—Excise Tax Provisions

House Committee Report (Code and Related Non-Code Provisions)

[*Aviation exemption for emergency medical aircraft*]

Clarify scope of aviation excise tax exemption for emergency medical aircraft.—The bill clarifies that this exemption is applied on a flight-by-flight basis.

[*Effective date.*—This provision is effective August 27, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,665] Act Sec. 1601(f)(5). Law at ¶ 5189 and 5377. CCH Explanation at ¶ 573.

Technical Corrections: 1996 Small Business Job Protection Act—Other Provisions

House Committee Report

[*Thrift institution reserves*]

Treatment of certain reserves of thrift institutions.—The bill provides rules to clarify the section 593(e) treatment of pre-1988 bad debt reserves of thrift and former thrift institutions that become S corporations. The technical corrections provide that (1) the accumulated adjustments account of an S corporation would be treated the same as post-1951 earnings and profits for purposes of section 593(e) and (2) section 593(e) would apply irrespective of section 1374 (e.g., distributions that trigger section 593(e) would be subject to corporate-level recapture even if such distributions occur after the 10-year period of section 1374).

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1995.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,670] Act Sec. 1601(f)(6). Law at ¶ 5271. CCH Explanation at ¶ 575.

Technical Corrections: 1996 Small Business Job Protection Act—Other Provisions

House Committee Report

[*FASITs*]

"FASIT" technical corrections.—

Definition of regular interest.—The bill provides that the requirement of a "regular interest" must be met "on or after the startup date," instead of just "after the startup date."

Correction of cross reference.—The bill corrects an incorrect cross reference in section 860L(d)from section 860L(c)(2) to section 860L(b)(2).

Tax on prohibited transactions.—The bill provides that the tax on prohibited transactions would not apply to dispositions of foreclosure property or hedges using the similar exception applicable to REMICs.

[*Effective date.*—These provisions are effective September 1, 1997.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,675] Act Sec. 1601(g)(1). Law at ¶ 5673. CCH Explanation at ¶ 1230.

Technical Corrections: 1996 Small Business Job Protection Act—Excise Tax Provisions

House Committee Report

[*Ethanol refund technical correction*]

Clarify effective date of technical correction related to ethanol refunds.—The bill clarifies that the technical correction relating to the expedited ethanol refunds was retroactive to the provision's expiration after September 30, 1995. Claims for refunds of tax paid during the period October 1, 1995, through the date of enactment of the Small Business Tax Act must be filed before 60 days after enactment of this bill.

[*Effective date.*—This provision is effective January 1, 1994.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,680] Act Sec. 1601(h)(1)(C). Law at ¶ 7076. CCH Explanation at ¶ 154.

Technical Corrections: 1996 Small Business Job Protection Act—Other Provisions

House Committee Report (Related Non-Code Provision)

[*Qualified State tuition plans*]

Qualified State tuition plans.—The provision clarifies that, if a State program under which persons may purchase tuition credits comes into compliance with the requirements of a "qualified State tuition program" as defined in section 529 within a specified time period, then such program will be treated as a qualified State tuition program with respect to any contributions (and earnings allocable thereto) made pursuant to a contract entered into under the program before the date on which the program comes into compliance with the present-law requirements of a qualified State tuition program under section 529.

[*Effective date.*—This provision is generally effective for tax years ending after August 20, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,685] Act Sec. 1601(h)(2)(A) and (h)(2)(B). Law at ¶ 5003. CCH Explanation at ¶ 122.

Technical Corrections: 1996 Small Business Job Protection Act—Other Provisions

House Committee Report

[*Adoption tax credit*]

Adoption tax credit.—The technical correction conforms the treatment of otherwise qualified adoption expenses paid or incurred in years after the year the adoption becomes final to the treatment of expenses paid or incurred in the year the adoption becomes final. Another technical correction repeals as "deadwood" an ordering rule inadvertently included in the credit.

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,695] Act Sec. 1601(h)(2)(C). Law at ¶ 5059. CCH Explanation at ¶ 125.

Technical Corrections: 1996 Small Business Job Protection Act—Other Provisions

House Committee Report

[*Adoption assistance exclusion*]

Phaseout of adoption assistance exclusion.—The technical correction conforms the phaseout range of the adoption assistance exclusion to the phaseout range of the credit for qualified adoption expenses.

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,715] Act Sec. 1601(i)(2). Law at ¶ 5209. CCH Explanation at ¶ 977.

Technical Corrections: 1996 Small Business Job Protection Act—Foreign Provisions

House Committee Report

[*Transfers to foreign trusts at FMV*]

Transfers to foreign trusts at fair market value.—The technical correction clarifies that, for purposes of determining whether a U.S. person's transfer to a trust is for fair market value consideration, the related persons whose obligations are disregarded include any owner of the trust and certain persons who are related to any such owner.

[*Effective date.*—This provision is effective for transfers of property after February 6, 1995.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,720] Act Sec. 1601(i)(3). Law at ¶ 5193 and 5745. CCH Explanation at ¶ 975.

Technical Corrections: 1996 Small Business Job Protection Act—Foreign Provisions

House Committee Report

[*Trust as U.S. person*]

Treatment of trust as U.S. person.—The technical correction clarifies that a trust is treated as a U.S. person as long as one or more U.S. *persons* have the authority to control all substantial decisions of the trust (and a U.S. court can exercise primary supervision). Accordingly, the fact that a substantial decision of the trust is controlled by a U.S. person who is not a fiduciary would not cause the trust not to be treated as a U.S. person. In addition, the technical correction clarifies that a trust that is a foreign trust under these criteria is not considered to be present or resident in the United States at any time. Finally, the technical correction provides the Secretary of Treasury with authority to allow reasonable time for U.S. trusts in existence on August 20, 1996 to make modifications in order to comply with the new criteria for treatment of a trust as a U.S. person.

[*Effective date.*—This provision is generally effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,755] Act Sec. 1602(a)(1). Law at ¶ 5011. CCH Explanation at ¶ 801.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*MSAs: Nonmedical distributions*]

Medical savings accounts.—

Additional tax on distributions not used for medical purposes.—The bill provides that the 15-percent tax on nonmedical withdrawals from an MSA is not treated as tax liability for purposes of the minimum tax.

* * *

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,760] Act Sec. 1602(a)(2). Law at ¶ 5087. CCH Explanation at ¶ 804.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*MSAs: Permitted coverage*]

Medical savings accounts.—

* * *

Definition of permitted coverage.—Under the bill Medicare supplemental plans would be deleted from the types of permitted coverage an individual may have and still qualify for an MSA.

* * *

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,765] Act Sec. 1602(a)(3). Law at ¶ 5087. CCH Explanation at ¶ 807.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*MSAs: Taxation of distributions*]

Medical savings accounts.—

* * *

Taxation of distributions.—The bill would clarify that, in any year for which a contribution is made to an MSA, withdrawals from the MSA are excludable from income only if the individual for whom the expenses were incurred was covered under a high deductible health plan (and no other health plan except for plans that provide certain permitted coverage) in the month in which the expenses were incurred. That is, the individual for whom the expenses were incurred does not have to be self employed or employed by a small employer in order for a withdrawal for medical expenses to be excludible.

* * *

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,770] Act Sec. 1602(a)(4). Law at ¶ 5703. CCH Explanation at ¶ 811.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*MSAs: Failure to file required reports*]

Medical savings accounts.—

* * *

Penalty for failure to provide required reports.—The bill provides that the $50 penalty does not apply to information returns.

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,815] Act Sec. 1602(b). Law at ¶ 5747. CCH Explanation at ¶ 835.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*Chronically ill individual: Qualified long-term insurance contract*]

Definition of chronically ill individual under a qualified long-term care insurance contract.—The technical correction clarifies that the five-activity requirement—i.e., that the number of activities of daily living that are taken into account not be less than five—applies only for purposes of the first of three alternative definitions of a chronically ill individual (Code sec. 7702B(c)(2)(A)(i)), that is, by reason of the individual being unable to perform (without substantial assistance) at least 2 activities of daily living for at least 90 days due to a loss of functional capacity. Thus, the requirement does not apply to the determination of whether an individual is a chronically ill individual either (1) by virtue of severe cognitive impairment, or (2) if the insured satisfies a standard (if any) that is not based upon activities of daily living, as determined under regulations.

[*Effective date.*—This provision is generally effective for contracts issued after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,820] Act Sec. 1602(c). Law at ¶ 5067. CCH Explanation at ¶ 837.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*Long-term care insurance: Self-employed individuals*]

Deduction for long-term care insurance of self-employed individuals.—The technical correction applies the rules for the deduction for health insurance expenses of a self-employed individual separately with respect to (1) plans that include coverage for qualified long-term care services or that are qualified long-term care insurance contracts, and (2) plans that do not include such coverage and are not such contracts. Thus, the provision clarifies that the fact that an individual is eligible for employer-subsidized health insurance does not affect the ability of such an individual to deduct long-term care insurance premiums, so long as the individual is not eligible for employer-subsidized long-term care insurance.

[*Effective date.*—This provision is effective for tax years beginning after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,825] Act Sec. 1602(d). Law at ¶ 5607, 5691 and 5711. CCH Explanation at ¶ 839.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*Long-term care contract and accelerated death benefit reporting*]

Applicability of reporting requirements of long-term care contracts and accelerated death benefits.—The technical correction clarifies that the reporting requirements include the need to report the address and phone number of the information contact. This conforms these reporting requirements to the requirements of the Taxpayer Bill of Rights 2.

[*Effective date.*—This provision is effective for benefits paid after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,830] Act Sec. 1602(e). Law at ¶ 5747. CCH Explanation at ¶ 841.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*Long-term care insurance: Consumer protection*]

Consumer protection provisions for long-term care insurance contracts.—The technical correction clarifies that the nonforfeiture provision shall provide for a benefit available in the event of a default in the payment of any premiums and the amount of the benefit may be adjusted subsequent to being initially granted only as necessary to reflect changes in claims, persistency, and interest as reflected in changes in rates for premium paying policies approved by the appropriate State regulatory authority (not by the Secretary) for the same contract form.

[*Effective date.*—This provision is effective for contracts issued after December 31, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,845] Act Sec. 1602(f)(1). Law at ¶ 5097. CCH Explanation at ¶ 848.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*COLI: Insurable interests*]

Insurable interests under the COLI provision.—The technical correction is intended to prevent unintended avoidance of the COLI rule by clarifying that the rule relates to life insurance policies or annuity or endowment contracts covering any individual who (1) is or was an officer or employee of, or (2) is or was financially interested in, any trade or business carried on currently or formerly by the taxpayer. Thus, for example, the provision would clarify the treatment of interest on debt with respect to contracts covering former employees of the taxpayer. As another example, the provision would clarify the treatment of interest on debt with respect to a business formerly conducted by the taxpayer and transferred to an affiliate of the taxpayer. No inference is intended as the interpretation of this provision under prior law.

[*Effective date.*—This provision is generally effective for interest paid or accrued after October 13, 1995.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,850] Act Sec. 1602(f)(2). Law at ¶ 5097. CCH Explanation at ¶ 851.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*COLI: Variable rate contract interest rate*]

Applicable period for purposes of applying the interest rate for a variable rate contract under the COLI rules.—The technical correction provides that an election of an applicable period for purposes of applying the interest rate for a variable rate contract can be made no later than the 90th date after the date of enactment of the proposal, and applies to the taxpayer's first taxable year ending on or after October 13, 1995. If no election is made, the applicable period is the policy year. The policy year is the 12-month period beginning on the anniversary date of the policy.

[*Effective date.*—This provision is generally effective for interest paid or accrued after October 13, 1995.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,855] Act Sec. 1602(f)(3). Law at ¶ 5097. CCH Explanation at ¶ 854.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*20-percent owner: COLI key person exception*]

Definition of 20-percent owner for purposes of key person exception under COLI rule.—The technical correction clarifies that, in determining a key person, if the taxpayer is not a corporation, a 20-percent owner is an individual who directly owns 20 percent or more of the capital or profits interest of the taxpayer.

[*Effective date.*—This provision is generally effective for interest paid or accrued after October 13, 1995.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,860] Act Sec. 1602(f)(4). Law at ¶ 7079. CCH Explanation at ¶ 857.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report (Related Non-Code Provision)

[*COLI effective dates: Key person interest rate cap: Pre-1986 contracts*]

Effective date of interest rate cap on key persons and pre-1986 contracts under the COLI rule.—The technical correction clarifies that, under the COLI rule, the interest rate cap on key persons and pre-1986 contracts applies to interest paid or accrued for any month beginning after December 31, 1995. This technical correction eliminates the discrepancy between the October and the December dates in the grandfather rule for pre-1986 contracts.

[*Effective date.*—This provision is generally effective for interest paid or accrued after October 13, 1995.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,865] Act Sec. 1602(f)(5). Law at ¶ 7079. CCH Explanation at ¶ 861.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report (Related Non-Code Provision)

[*Contract lapses: COLI effective date*]

Clarification of contract lapses under effective date provisions of the COLI rule.—The technical correction clarifies that, under the transition relief provided under the COLI rule, the 4-out-of-7 rule and the single premium rule of present law are not to apply solely by reason of a lapse occurring by reason of no additional premiums being received under the contract after October 13, 1995.

[*Effective date.*—This provision is generally effective for interest paid or accrued after October 13, 1995.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

In addition, the conference agreement makes the following additions, modifications, and clarifications relating to the technical correction provisions.

* * *

The conference agreement clarifies that, under the transition relief provided under the company-owned life insurance rule, the 4-out-of-7 rule and the single premium rule of present law are not to apply solely by reason of a lapse occurring after October 13, 1995, by reason of no additional premiums being received under the contract.

[¶ 13,875] Act Sec. 1602(g)(1). Law at ¶ 5279. CCH Explanation at ¶ 926.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*Expatriation: Gain recognition: 10-year period*]

Requirement of gain recognition on certain exchanges.—The technical correction clarifies that the period to which the general rule requiring gain recognition on certain exchanges applies is the 10-year period that begins on the date of loss of U.S. citizenship or U.S. residency status. * * *

[*Effective date.*—This provision is generally effective for individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,880] Act Sec. 1602(g)(2). Law at ¶ 5279. CCH Explanation at ¶ 926.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report (Related Non-Code Provision)

[*Expatriation: Gain recognition: 5-year period*]

Requirement of gain recognition on certain exchanges.—* * * In addition, the technical correction clarifies that in the case of an exchange occurring during the 5-year period before the loss of U.S. citizenship or U.S. residency status, any gain required to be recognized under regulations is to be recognized immediately after the date of such loss of U.S. citizenship.

[*Effective date.*—This provision is generally effective for individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,885] Act Sec. 1602(g)(3). Law at ¶ 5279. CCH Explanation at ¶ 928.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*Suspend 10-year period: Risk of loss substantially diminished*]

Suspension of 10-year period in case of substantial diminution of risk of loss.—Under the expatriation tax provisions in section 877, special tax treatment applies to certain former U.S. citizens and former long-term U.S. residents for 10 years following the date of loss of U.S. citizenship or U.S. residency status. The running of this period with respect to gain on the sale or exchange of any property is suspended for any period during which the individual's risk of loss with respect to the property is substantially diminished. * * *

The technical correction clarifies that the period to which the rule suspending such period in the case of a substantial diminution of risk of loss applies is the 10-year period that begins on the date of loss of U. S. citizenship or U.S. residency status.

[*Effective date.*—This provision is generally effective for individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,890] Act Sec. 1602(g)(4). Law at ¶ 5279. CCH Explanation at ¶ 929.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*Expatriation: Property contributed to certain foreign corporations*]

Treatment of property contributed to certain foreign corporations.—The technical correction clarifies that the period to which the rule regarding certain contributions to foreign corporations applies is the 10-year period that begins on the date of loss of U.S. citizenship or U.S. residency status. The technical correction also clarifies that the rule applies in the case of property the income from which, immediately before the contribution, was from U.S. sources.

[*Effective date.*—This provision is generally effective for individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,895] Act Sec. 1602(g)(6). Law at ¶ 5443. CCH Explanation at ¶ 930.

Technical Corrections: 1996 Health Insurance Portability and Accountability Act

House Committee Report

[*Expatriation: Foreign estate tax credit*]

Credit for foreign estate tax.—The technical correction clarifies the formula for determining the amount of the foreign tax credit allowable against U.S. estate taxes on property includible in the decedent's U.S. estate solely by reason of the expatriation estate tax provisions. The credit for the estate taxes paid to any foreign country generally is limited to the lesser of (1) the foreign estate taxes attributable to the property includible in the decedent's U.S. estate solely by reason of the expatriation estate tax provisions or (2) the U.S. estate tax attributable to property that is subject to estate tax in such foreign country and is includible in the decedent's U.S. estate solely by reason of the expatriation tax provisions. The amount of taxes attributable to such property is determined on a pro rata basis.

[*Effective date.*—This provision is generally effective for individuals losing U.S. citizenship on or after February 6, 1995, and long-term U.S. residents who end U.S. residency or begin foreign residency on or after February 6, 1995.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,915] Act Sec. 1603(a). Law at ¶ 5523. CCH Explanation at ¶ 619.

Technical Corrections: Taxpayer Bill of Rights 2

House Committee Report

[*Reasonable cause abatement: First-tier intermediate sanctions tax*]

Reasonable cause abatement for first-tier intermediate sanctions excise tax.—The bill amends section 4962(b) to include a cross-reference to first-tier taxes imposed by subchapter D (i.e., the section 4958 excise taxes on excess benefit transactions). Thus, the IRS has authority to abate the first-tier excise taxes on excess benefit transactions in cases where it is established that the violation was due to reasonable cause and not due to willful neglect and the transaction at issue was corrected within the specified period.

[*Effective date.*—This provision is generally effective for excess benefit transactions occurring on or after September 14, 1995.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,920] Act Sec. 1603(b). Law at ¶ 5583. CCH Explanation at ¶ 621.

Technical Corrections: Taxpayer Bill of Rights 2

House Committee Report

[*Public charity reporting*]

Reporting by public charities with respect to intermediate sanctions and certain other excise tax penalties.—The bill makes the reporting requirements of section 6033(b)(10) and (11) consistent with the excise tax penalty provisions to which they relate. Thus, section 6033(b)(10) is amended to require 501(c)(3) organizations to report any amounts of tax imposed under sections 4911, 4912, and 4955 on the organization or any organization manager of the organization. In addition, the bill requires reporting with respect to any reimbursements paid by an organization with respect to taxes imposed under sections 4912 or 4955 on any organization manager of the organization. Section 6033(b)(11) is amended to require 501(c)(3) organizations to report any amounts of tax imposed under section 4958 on any organization manager or any disqualified person, as well as any reimbursements of section 4958 excise tax liability paid by the organization to such organization managers or disqualified persons.

In addition, the bill clarifies that no reporting is required under sections 6033(b)(10) or (11) in the event a first-tier penalty excise tax imposed under section 4955 or section 4958 is abated by the IRS pursuant to its authority under section 4962.

[*Effective date.*—This provision is effective for returns for tax years beginning after July 30, 1996.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,935] Act Sec. 1604(b)(3) and (4). Law at ¶ 7082. CCH Explanation at ¶ 788.

Technical Corrections: Other Acts

House Committee Report (Related Non-Code Provision)

[*GATT interest and mortality rates*]

Correction of GATT interest and mortality rate provisions in the Retirement Protection Act.—The provision in the Small Business Act was intended to permit plans to apply pre-GATT law under section 415(b)(2)(E) for a transition period. The bill conforms the statute to this intent by providing that determinations under section 415(b)(2)(E) before such earlier date are to be made with respect to such benefits on the basis of

such section as in effect on December 7, 1994 and the provisions of the plan as in effect on December 7, 1994, but only if such provisions of the plan meet the requirements of such section (as so in effect).

[*Effective date.*—This provision is generally effective for plan years and limitation years beginning after December 31, 1994.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,940] Act Sec. 1604(c)(1) and (c)(2). Law at ¶ 5075. CCH Explanation at ¶ 328.

Technical Corrections: Other Acts

House Committee Report

[*Indian reservation definition*]

Clarify definition of Indian reservation under section 168(j)(6).—For purposes of the section 168(j)(6) definition of "Indian reservation," the term "former reservations in Oklahoma" is defined as lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 51.

Effective date.—The provision generally is effective as if included in the Omnibus Budget Reconciliation Act of 1993 (i.e., the technical correction applies to property placed in service and wages paid on or after January 1, 1994). However, the provision does not apply to wages claimed on any original return filed prior to March 18, 1997, nor does it apply to property placed in service with a 10-year life or less (without regard to section 168(j)) if accelerated depreciation under section 168(j) was claimed with respect to such property on an original return filed prior to March 18, 1997.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill, except that the Senate amendment (1) does not contain the provision that defines the term "former reservations in Oklahoma" for purposes of section 168(j)(6) (relating to certain tax benefits provided with reference to activities occurring on Indian reservations) * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. Thus, the conference agreement contains both the provision in the House bill relating to the definition of the term "former reservations in Oklahoma" * * *.

[¶ 13,945] Act Sec. 1604(d)(2). Law at ¶ 5259. CCH Explanation at ¶ 577.

Technical Corrections Provisions

Conference Committee Report

[*Blue Cross and Blue Shield organizations*]

* * *

The conference agreement clarifies that, for purposes of the section 833 deduction, liabilities incurred during the taxable year under cost-plus contracts are added to claims incurred under section 833(b)(1)(A)(i). Similarly, for purposes of the section 833 deduction, expenses incurred during the taxable year in connection with cost-plus contracts are added to expenses incurred under section 833(b)(1)(A)(ii). The provision is effective as if included in the Tax Reform Act of 1986.

* * *

[¶ 13,950] Act Sec. 1604(e). Law at ¶ 5101. CCH Explanation at ¶ 521.

Technical Corrections: Other Acts

House Committee Report

[*Related parties: Code Sec. 267*]

Related parties determined by reference to section 267.—Any provision of the Internal Revenue Code of 1986 that refers to a relationship that would result in loss disallowance under section 267 also refers to relationships where loss is deferred, where such relationship is applicable to the provision.

[*Effective date.*—This provision is generally effective for transactions after December 31, 1983, in tax years ending after such date.—CCH.]

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill * * *.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment. * * *

[¶ 13,955] Act Sec. 1604(f)(3). Law at ¶ 7082. CCH Explanation at ¶ 1257 and 1258.

Revenue-Increase Provisions—Excise Tax

Conference Committee Report (Related Non-Code Provision)

[*Tobacco excise taxes*]

* * *

The conference agreement includes a technical amendment to H.R. 2015, which provides that an amount equal to the increase in tobacco excise taxes included in H.R. 2015 will be credited against total payments made by parties pursuant to future Federal legislation implementing the proposed tobacco industry settlement agreement of June 20, 1997.

* * *

[*Effective date.*—This provision is effective immediately after the effective date of Act Sec. 9302 of the Balanced Budget Act of 1997 (See Committee Report ¶ 20,085 for the effective date of Act Sec. 9302).—CCH.]

[¶ 14,015] Act Sec. 1701. Law at ¶ 7085. CCH Explanation at ¶ 12.

Identification of Limited Tax Benefits Subject to Line Item Veto

Conference Committee Report (Related Non-Code Provision)

[*Line item veto*]

Identification of limited tax benefits subject to line item veto.—The Line Item Veto Act amended the Congressional Budget and Impoundment Act of 1974 to grant the President the limited authority to cancel specific dollar amounts of discretionary budget authority, certain new direct spending, and limited tax benefits. The Line Item Veto Act provides that the Joint Committee on Taxation is required to examine any revenue or reconciliation bill or joint resolution that amends the Internal Revenue Code of 1986 prior to its filing by a conference committee in order to determine whether or not the bill or joint resolution contains any limited tax benefits and to provide a statement to the conference committee that either (1) identifies each limited tax benefit contained in the bill or resolution, or (2) states that the bill or resolution contains no limited tax benefits. The conferees determine whether or not to include the Joint Committee's statement in the conference report. If the conference report includes the information from the Joint Committee on Taxation identifying provisions that are limited tax benefits, then the President may cancel one or more of those, but only those, provisions that have been identified. If such a conference report contains a statement from the Joint Committee on Taxation that none of the provisions in the conference report are limited tax benefits, then the President has no authority to cancel any of the specific tax provisions, because there are no tax provisions that are eligible for cancellation under the Line Item Veto Act.

The conference report contains a list of provisions that have been identified by the Joint Committee on Taxation as limited tax benefits within the meaning of the Line Item Veto Act. These provisions are listed below

(1) Sec. 101(c) (relating to high risk pools permitted to cover dependents of high risk individuals)

(2) Sec. 222 (relating to limitation on qualified 501(c)(3) bonds other than hospital bonds)

(3) Sec. 224 (relating to contributions of computer technology and equipment for elementary or secondary school purposes)

(4) Sec. 312(a) (relating to treatment of remainder interests for purposes of provision relating to gain from sale of principal residence)

(5) Sec. 501(b) (relating to indexing of alternative valuation of certain farm, etc., real property)

(6) Sec. 405 (relating to extension of treatment of certain rents under section 2032A to lineal descendants)

(7) Sec. 505 (relating to clarification of judicial review of eligibility for extension of time for payment of estate tax)

(8) Sec. 508 (relating to treatment of land subject to qualified conservation easement)

(9) Sec. 511 (relating to expansion of exception from generation-skipping transfer tax for transfers to individuals with deceased parents)

(10) Sec. 601 (relating to research tax credit)

(11) Sec. 602 (relating to contributions of stock to private foundations)

(12) Sec. 603 (relating to the work opportunity tax credit)

(13) Sec. 604 (relating to orphan drug tax credit)

(14) Sec. 701 (relating to incentives for revitalizations of the District of Columbia) to the extent it amends the Internal Revenue Code of 1986 to create sections 1400 and 1400A (relating to tax-exempt economic development bonds)

(15) Sec.701 (relating to incentives for revitalization of the District of Columbia) to the extent it amends the Internal Revenue Code of 1986 to create section 1400C (relating to first-time homebuyer credit for District of Columbia)

(16) Sec. 801 (relating to incentives for employing long-term family assistance recipients)

(17) Sec. 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine containing pertussis bacteria, extracted or partial cell bacteria, extracted or partial cell bacteria, or specific pertussis antigens

(18) Sec. 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine against measles

(19) Sec. 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine against mumps

(20) Sec. 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine against rubella

(21) Sec. 905 (relating to operators of multiple retail gasoline outlets treated as wholesale distributors for refund purposes)

(22) Sec. 906 (relating to exemption of electric and other clean-fuel motor vehicles from luxury automobile classification)

(23) Sec. 907(a) (relating to rate of tax on liquified natural gas determined on basis of BTU equivalency with gasoline)

(24) Sec. 907(b) (relating to rate of tax on methanol from natural gas determined on basis of BTU equivalency with gasoline)

(25) Sec. 908 (relating to modification of tax treatment of hard cider)

(26) Sec. 914 (relating to mortgage financing for residence located in disaster areas)

(27) Sec. 962 (relating to assignment of workmen's compensation liability eligible for exclusion relating to personal injury liability assignments)

(28) Sec. 963 (relating to tax-exempt status for certain State worker's compensation act companies)

(29) Sec. 967 (relating to additional advance refunding of certain Virgin Islands bonds)

(30) Sec. 968 (relating to nonrecognition of gain on sale of stock to certain farmers' cooperative)

(31) Sec. 971 (relating to exemption of the incremental cost of a clean fuel vehicle from the limits on depreciation for vehicles)

(32) Sec. 974 (relating to clarification of treatment of certain receivables purchased by cooperative hospital service organizations)

(33) Sec. 975 (relating to deduction in computing adjusted gross income for expenses in connection with service performed by certain officials) with respect to taxable years beginning before 1991

(34) Sec. 977 (relating to elective carryback of existing carryovers of National Railroad Passenger Corporation)

(35) Sec. 1005(b)(2)(B) (relating to transition rule for instruments described in a ruling request submitted to the Internal Revenue Service on or before June 8, 1997)

(36) Sec. 1005(b)(2)(C) (relating to transition rule for instruments described on or before June 8, 1997, in a public announcement or in a filing with the Securities and Exchange Commission) as it relates to a public announcement

(37) Sec. 1005(b)(2)(C) (relating to transition rule for instruments described on or before June 8, 1997, in a public announcement or in a filing with the Securities and Exchange Commission) as it relates to a filing with the Securities and Exchange Commission

(38) Sec. 1011(d)(2)(B) (relating to transition rule for distributions made pursuant to the terms of a tender offer outstanding on May 3, 1995)

(39) Sec. 1011(d)(3) (relating to transition rule for distributions made pursuant to the

terms of a tender offer outstanding on September 13, 1994)

(40) Sec. 1012(d)(3)(B) (relating to transition rule for distributions pursuant to an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 described in a ruling request submitted to the Internal Revenue Service on or before April 16, 1997)

(41) Sec. 1012(d)(3)(C) (relating to transition rule for distributions pursuant to an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 described in a public announcement or filing with the Securities and Exchange Commission) as it relates to a public announcement

(42) Sec. 1012(d)(3)(C) (relating to transition rule for distributions pursuant to an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 described in a public announcement or filing with the Securities and Exchange Commission) as it relates to a filing with the Securities and Exchange Commission

(43) Sec. 1013(d)(2)(B) (relating to transition rule for distributions or acquisitions after June 8, 1997, described in a ruling request submitted to the Internal Revenue Service submitted on or before June 8, 1997)

(44) Sec. 1013(d)(2)(C) (relating to transition rule for distributions or acquisitions after June 8, 1997, described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a public announcement

(45) Sec. 1013(d)(2)(C) (relating to transition rule for distributions or acquisitions after June 8, 1997, described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a filing with the Securities and Exchange Commission

(46) Sec. 1014(f)(2)(B) (relating to transition rule for any transaction after June 8, 1997, if such transaction is described in a ruling request to the Internal Revenue Service submitted on or before June 8, 1997)

(47) Sec. 1014(f)(2)(C) (relating to transition rule for any transaction after June 8, 1997, if such transaction is described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a public announcement

(48) Sec. 1014(f)(2)(C) (relating to transition rule for any transaction after June 8, 1997, if such transaction is described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a filing with the Securities and Exchange Commission

(49) Sec. 1042(b) (relating to special rules for provision terminating certain exceptions from rules relating to exempt organizations which provide commercial-type insurance)

(50) Sec. 1081(a) (relating to termination of suspense accounts for family corporations required to use accrual accounting) as it relates to the repeal of Internal Revenue Code section 447(i)(3)

(51) Sec. 1089(b)(3) (relating to reformations)

(52) Sec. 1089(b)(5)(B)(i) (relating to persons under a mental disability)

(53) Sec. 1171 (relating to treatment of computer software as FSC export property)

(54) Sec. 1175 (relating to exemption for active financing income)

(55) Sec. 1204 (relating to travel expenses of Federal employees doing criminal investigations)

(56) Sec. 1236 (relating to extension of time for filing a request for administrative adjustment)

(57) Sec. 1243 (relating to special rules for administrative adjustment request with respect to bad debts or worthless securities)

(58) Sec. 1251 (relating to clarification on limitation on maximum number of shareholders)

(59) Sec. 1253 (relating to attribution rules applicable to tenant ownership)

(60) Sec. 1256 (relating to modification of earnings and profits rules for determining whether REIT has earnings and profits from non-REIT years)

(61) Sec. 1257 (relating to treatment of foreclosure property)

(62) Sec. 1261 (relating to shared appreciation mortgages)

(63) Sec. 1301 (relating to clarification of waiver of certain rights of recovery)

(64) Sec. 1303 (relating to transitional rule under section 2056A)

(65) Sec. 1304 (relating to treatment for estate tax purposes of short-term obligations held by nonresident alien)

(66) Sec. 1311 (relating to clarification of treatment of survivor annuities under qualified terminable interest rules)

(67) Sec. 1312 (relating to treatment of qualified domestic trust rules of forms of ownership which are not trusts)

(68) Sec. 131 (relating to opportunity to correct failures under section 2032A)

(69) Sec. 141 (relating to fermented material from any brewery may be received at a distilled spirits plant)

(70) Sec. 1417 (relating to use of additional ameliorating material in certain wines)

(71) Sec. 1418 (relating to domestically produced beer may be withdrawn free of tax for use of foreign embassies, legations, etc.)

(72) Sec. 1421 (relating to transfer to brewery of beer imported in bulk without payment of tax)

(73) Sec. 1422 (relating to transfer of bonded wine cellars of wine imported in bulk without payment of tax)

(74) Sec. 1506 (relating to clarification of certain rules relating to employee stock ownership plans of S corporations)

(75) Sec. 1507 (relating to modification of 10 percent tax for nondeductible contributions)

(76) Sec. 1253 (relating to repeal of application of unrelated business income tax to ESOPs)

(77) Sec. 1530 (relating to gratuitous transfers for the benefit of employees)

(78) Sec. 1532 (relating to special rules relating to church plans)

(79) Sec. 1604(c)(2) (relating to amendment related to Omnibus Budget Reconciliation Act of 1993)

[¶ 14,025] CCH Explanation at ¶ 184.

Pension Simplification

Conference Committee Report (Related Non-Code Provision)

[*IRA contributions through payroll deductions*]

* * *The conference agreement provides that employers that choose not to sponsor a retirement plan should be encouraged to set up a payroll deduction system to help employees save for retirement by making payroll deduction contributions to their IRAs. The Secretary of Treasury is encouraged to continue his efforts to publicize the availability of these payroll deduction IRAs.

Committee Reports

Balanced Budget Act

¶ 20,001

Reproduced below are the pertinent texts of the controlling Committee Reports that explain the changes enacted by the Balanced Budget Act of 1997 (P.L. 105-33). The material herein is the official wording of the relevant House, Senate and Conference Reports, arranged in Act Section order. Headings have been added for convenience in locating the relevant Committee Reports. Any omission of text is indicated by asterisks (*). Where the Act incorporates other legislation, the relevant Committee Reports that have accompanied that legislation have been included.

References to the official reports are to the following:

• House Ways and Means Committee Report, No. 105-149 (H.R. 2015) referred to as **House Committee Report.**

• Senate Finance Committee Report on the Taypayer Relief Bill of 1997 (S. 949), as released on June 20, 1997, issued as CCH Special 5, STANDARD FEDERAL TAX REPORTS No. 27 (Second Extra Issue), June 25, 1997, referred to as **Senate Committee Report.**

• Selected portions of the Conference Committee Report on the Balanced Budget Bill of 1997 (H.R. 2015), included in the Taxpayer Relief Bill of 1997 Conference Report and Statement of the Managers, as released on July 31, 1997, issued as a CCH Special, STANDARD FEDERAL TAX REPORTS, August 4, 1997, referred to as **Conference Committee Report.**

[¶ 20,010] Act Sec. 4001. Law at ¶ 7091. CCH Explanation at 817, 819, 821, 823, 825, 827 and 829.

Medicare+Choice Program

Conference Committee Report (Title 1: Related Non-Code Provision)

[*Medicare+Choice Program*]

House Bill.—Section 10001 (new section 1851). The Social Security Act would be amended to insert a new Part C, MedicarePlus New section 1851 of Part C of the Social Security Act would specify requirements related to eligibility, election of coverage, and enrollment.

Section 4001 (new section 1851). Identical provision.

Senate Amendment.—Identical except the new program of choices would be called Medicare+Choice.

Conference Agreement.—The conference agreement includes provisions that are identical in the House bill and Senate amendment except that the new program of choices would be called Medicare+Choice. Except for the addition of HMOs, modest benefit changes, and episodic reforms in provider payment methods, the Medicare program has remained essentially unchanged since the program's inception in 1965. This contrasts starkly with the health benefit design, delivery, and cost containment innovations that have occurred in the private sector and, to a great extent, have been captured by the Federal Employee Health Benefit Program (FEHBP). The creation of Medicare+Choice will allow beneficiaries to have access to a wide array of private health plan choices in addition to traditional fee-for-service Medicare. In addition, it will enable the Medicare program to utilize innovations that have helped the private market contain costs and expand health care delivery options.

The Conferees believe that one of the most significant innovations is the Medical Savings Account (MSA). MSAs can give the elderly genuine catastrophic protection, which the traditional Medicare program does not guarantee. Well over 400,000 Medicare beneficiaries experience out-of-pocket costs in excess of $5,000 every year, causing financial ruin in many cases. In contrast, MSA plans could significantly limit such costs—even for chronically ill beneficiaries. In addition, Medical Savings Accounts can help discourage overutilization and can give seniors more control over their health care dollars.

Building upon the private market MSA demonstration program available to small employers and the self-employed under the recently-enacted bipartisan Health Insurance Portability and Accountability Act (HIPAA), the conference agreement would authorize a demonstration of Medicare MSAs available to 390,000 of the 33 million senior citizens eligible for Medicare. The Conferees note that this demonstration is smaller relative to the size of the eligible population than the HIPAA demonstration program, reaching less than 2 percent of Medicare beneficiaries. Nevertheless, it is the hope and intent of the Conferees that this number will allow a true test of the potential benefits to the program and to beneficiaries of the MSA concept. In addition, the Conferees note that the private fee-for-service Medicare+Choice option authorized by this agreement represents the first defined contribution plan in which beneficiaries may enroll in the history of the program.

* * *

House Bill.—Section 10001 (new section 1851(b)). In general, an individual would be eligible to elect a MedicarePlus plan by a MedicarePlus organization only if the organization served the geographic area in which the individual resided. Enrollment could continue if the plan provided benefits for enrollees located in the area to which the individual moved. An individual eligible for an annuity under the Federal Employee Health Benefits Program would not be eligible for an MSA plan until the Office of Management and Budget adopted policies to ensure that such enrollment did not result in increased expenditures for the federal government for FEHBP plans. The Secretary could apply similar rules in the case of individuals who are eligible for Departments of Defense or Veterans' Affairs health care. An individual who is a qualified Medicare beneficiary (QMB), a qualified disabled and working individual, a specified low-income Medicare beneficiary (SLMB), or otherwise entitled to Medicare cost-sharing assistance under a state Medicaid program, would not be eligible to enroll in an MSA plan.

In addition, individuals would not be eligible to enroll in an MSA plan on or after January 1, 2003, or as of any date if the number of individuals enrolled in MSA plans reached 500,000. Under rules established by the Secretary, an individual would not be eligible to enroll or continue enrollment in an MSA unless the individual would be residing in the U.S. for at least 183 days during the year. Individuals enrolling in MSA plans prior to either of those two events would be allowed to continue such enrollment. The Secretary would be required to regularly evaluate and report to Congress on the impact of permitting enrollment of MSA plans on selection (including adverse selection), use of preventive care, access to care, and the financial status of the Trust Funds. In addition, the Secretary would be required to submit to Congress periodic reports on the number of individuals enrolled in MSA plans and to submit a report to Congress by no later than March 1, 2002 on whether the time limitation should be extended or removed, and whether any change should be made to the number of individuals permitted to enroll in Medicare MSAs.

Section 4001 (new section 1851(b)). Identical provision.

* * *

Conference Agreement.—The conference agreement includes the House provision with modifications relating to continuation of enrollment and to the size of the MSA demonstration. Plans would have to provide that individuals exercising the Medicare§ Choice option who no longer reside in the service area of such plan have, as part of the basic benefit package, reasonable access within the geographic area of the plan to the full range of services covered under the contract, subject to reasonable cost sharing liability in obtaining such benefits.

The enrollment in MSAs would be capped at 390,000.

[¶ 20,015] Act Sec. 4006. Law at ¶ 5060, 5060A, 5527 and 7091. CCH Explanation at ¶ 817, 819, 821, 823, 825, 827 and 829.

MedicarePlus Program—Special Rules for MedicarePlus MSAs

Conference Committee Report (Code and Title 1: Related Non-Code Provisions)

[*MedicarePlus MSA*]

House Bill.—

In general.—Under the bill, individuals who are eligible for Medicare are permitted to choose either the traditional Medicare program or a Medicare+Choice MSA plan. To the extent an individual chooses such a plan, the Secretary of Health and Human Services makes a specified contribution directly into a Medicare+Choice MSA designated by such individual. Only contributions by the Secretary of Health and Human Services can be made to a Medicare+Choice MSA and such contributions are not included in the taxable income of the Medicare+Choice MSA holder. Income earned on amounts held in a Medicare+Choice MSA are not currently includible in taxable income. Withdrawals from a Medicare+Choice MSA are excludable from taxable income if used for the qualified medical expenses

of the Medicare+Choice MSA holder. Withdrawals from a Medicare+Choice MSA that are not used for the qualified medical expenses of the account holder are includible in income and may be subject to an additional tax (described below).

Definition of Medicare+Choice MSAs.—In general, a Medicare+Choice MSA is an MSA that is designated as Medicare+Choice MSA and to which the only contributions that can be made are those by the Secretary of Health and Human Services.[2] Thus, a Medicare+Choice MSA is a tax-exempt trust (or a custodial account) created exclusively for the purpose of paying the qualified medical expenses of the account holder that meets requirements similar to those applicable to individual retirement arrangements ("IRAs").[3] The trustee of a Medicare+Choice MSA can be a bank, insurance company, or other person that demonstrates to the satisfaction of the Secretary of the Treasury that the manner in which such person will administer the trust will be consistent with applicable requirements.

A Medicare+Choice MSA trustee would be required to make such reports as may be required by the Secretary of the Treasury. A $50 penalty would be imposed for each failure to file without reasonable cause.

Taxation of distributions from a Medicare+Choice MSA.—Distributions from a Medicare+Choice MSA that are used to pay the qualified medical expenses of the account holder would be excludable from taxable income regardless of whether the account holder is enrolled in the Medicare+Choice MSA plan at the time of the distribution.[4] Qualified medical expenses are defined as under the rules relating to the itemized deduction for medical expenses. However, for this purpose, qualified medical expenses would not include any insurance premiums other than premiums for long-term care insurance, continuation insurance (so-called "COBRA coverage"), or premium for coverage while an individual is receiving unemployment compensation. Distributions from a Medicare+Choice MSA that are excludable from gross income under the provision can not be taken into account for purposes of the itemized deduction for medical expenses.

Distributions for purposes other than qualified medical expenses are includible in taxable income. An additional tax of 50 percent applies to the extent the total distributions for purposes other than qualified medical expenses in a taxable year exceed the amount by which the value of the Medicare+Choice MSA as of December 31 of the preceding taxable year exceeds 60 percent of the deductible of the plan under which the individual is covered. The additional tax does not apply to distributions on account of the disability or death of the account holder.

Following is an example of how the amount available to be withdrawn from a Medicare+Choice MSA without penalty is calculated.[5]

Year 4	*Year 1*	*Year 2*	*Year 3*
1. Deductible $3,000	$3,000	$3,000	$3,000
2. 60% of deductible 1,800	1,800	1,800	1,800
3. Contributions 1,300	1,300	1,300	1,300
4. Earnings 400	130	200	300
5. Total withdrawals 600	600	500	600
6. Closing account (Dec. 31 of current year) 3,930	830	1,830	2,830
7. Amount available for nonmedical withdrawal without penalty (2-3 from prior year, or 0 if less than 0) 1,030	0	0	30

Direct trustee-to-trustee transfers could be made from one Medicare+Choice MSA to another Medicare+Choice MSA without income inclusion.

The provision includes a correction mechanism so that if contributions for a year are erroneously made by the Secretary of Health and Human Services, such erroneous contributions can be returned to the Secretary of Health and Human Services (along with any attributable earnings) from the Medicare+Choice MSA without tax consequence to the account holder.

Treatment of Medicare+Choice MSA at death.—Upon the death of the account holder, if the beneficiary of the Medicare+Choice MSA is the account holder's surviving spouse, the surviving spouse may continue the Medicare+Choice MSA, but no new contributions could be made. Distributions from the Medicare+Choice MSA are

[2] Medicare Plus MSAs are not taken into account for purposes of the cap on non-MedicarePlus MSAs, nor are they subject to that cap.

[3] For example, no MedicarePlus MSA assets could be invested in life insurance contracts, MedicarePlus MSA assets could not be commingled with other property except in a common trust fund or common investment fund, and an account holder's interest in a MedicarePlus MSA would be nonforfeitable. In addition, if an account holder engages in a prohibited transaction with respect to a MedicarePlus MSA or pledges assets in a MedicarePlus MSA, rules similar to those for IRAs would apply, and any amounts treated as distributed to the account holder under such rules would be treated as not used for qualified medical expenses.

[4] Under the provision, medical expenses of the account holder's spouse or dependents would not be treated as qualified medical expenses.

[5] The numbers are provided for illustrative purposes only.

subject to the rules applicable to MSAs that are not Medicare+Choice MSAs. Thus, earnings on the account balance are not currently includible in income. Distributions from the account for the qualified medical expenses of the spouse or the spouse's dependents (or subsequent spouse) are not includible in income. Distributions not for such medical expenses are includible in income, and subject to a 15-percent excise tax unless the distribution is made after the surviving spouse attains age 65, dies, or becomes disabled.

If the beneficiary of a Medicare+Choice MSA is not the account holder's spouse, the Medicare+Choice MSA is no longer treated as a Medicare+Choice MSA and the value of the Medicare+Choice MSA on the account holder's date of death is included in the taxable income of the beneficiary for the taxable year in which the death occurred (under the rules applicable to MSAs generally). If the account holder fails to name a beneficiary, the value of the Medicare+Choice MSA on the account holder's date of death is to be included in the taxable income of the account holder's final income tax return (under the rules applicable to MSAs generally).

In all cases, the value of the Medicare+Choice MSA is included in the account holder's gross estate for estate tax purposes.

Effective date.—The provision is effective with respect to taxable years beginning after December 31, 1998.

Senate Amendment.—The Senate amendment is the same as the House bill (except that the account is called a Medicare Choice MSA).

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[¶ 20,035] Act Sec. 4041. Law at ¶ 5171. CCH Explanation at ¶ 606.

MedicarePlus Program—Medicare Payment Advisory Commission

House Committee Report

[*Hospitals which participate in PSOs*]

Tax treatment of hospitals which participate in provider-sponsored organizations.—The provision provides that an organization does not fail to be treated as organized and operated exclusively for a charitable purpose for purposes of Code section 501(c)(3) solely because a hospital which is owned and operated by such organization participates in a provider-sponsored organization ("PSO") (as defined in section 1845(a)(1) of the Social Security Act), whether or not such PSO is exempt from tax. Thus, participation by a hospital in a PSO (whether taxable or tax-exempt) is deemed to satisfy the first part of the inquiry under current IRS ruling practice.[2]

The provision does not change present-law restrictions on private inurement and private benefit. However, the provision provides that any person with a material financial interest in such a PSO shall be treated as a private shareholder or individual with respect to the hospital for purposes of applying the private inurement prohibition in Code section 501(c)(3). Accordingly, the facts and circumstances of each PSO arrangement are evaluated to determine whether the arrangement entails impermissible private inurement or more than incidental private benefit (e.g., where there is a disproportionate allocation of profits and losses to the non-exempt partners, the tax-exempt partner makes loans to the joint venture that are commercially unreasonable, the tax-exempt partner provides property or services to the joint venture at less than fair market value, or a non-exempt partner receives more than reasonable compensation for the sale of property or services to the joint venture).

The provision does not change present-law restrictions on lobbying and political activities. In addition, the restrictions of Code section 501(m) on the provision of commercial-type insurance continue to apply.

* * *

Effective date.—The provision is effective on the date of enactment.

Conference Committee Report

Senate Amendment.—The Senate amendment is the same as the House bill.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment.

[2] The qualification of a hospital as a tax-exempt charitable organization under section 501(c)(3) is determined as under present law. See Rev. Rul. 69-545, 1969-2 C.B. 117.

[¶ 20,045] Act Sec. 4631(c)(2). Law at ¶ 5613. CCH Explanation at ¶ 1049.

Medicare Secondary Payer Provisions

House Committee Report

[*Extend secondary payer provisions*]

Permanent extension of certain secondary payer provisions.—The provision would make permanent the provisions relating to the disabled and the data match program.

The provision would extend application of the MSP provisions for the ESRD population for 30 months. This would apply to items and services furnished on or after enactment with respect to periods beginning on or after the date that is 18 months prior to enactment.

Conference Committee Report

Senate Amendment.—Similar provision.

Effective date.—Enactment. ESRD provision applies to items and services furnished on or after enactment with respect to periods beginning on or after the date that is 18 months prior to enactment.

Conference Agreement.—The conference agreement includes provisions that are essentially identical in the House bill and Senate amendment.

[¶ 20,055] Act Sec. 5405. Law at ¶ 5468B. CCH Explanation at ¶ 1123.

Welfare Reform—Unemployment Compensation

House Committee Report

[*Service performed by election workers*]

Exemption of service performed by election workers from the federal unemployment tax.—The proposal would exempt from FUTA taxes and UI benefits work performed as an election official or election worker. This exemption would apply only if the annual wages received by the individual for such service is less than $1,000.

* * *

Effective date.—Date of enactment.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 20,065] Act Sec. 5406. Law at ¶ 5468. CCH Explanation at ¶ 1126.

Welfare Reform—Unemployment Compensation

House Committee Report

[*Service performed by inmates*]

Treatment of certain services performed by inmates.—The proposal would exempt wages paid to persons committed to penal institutions from the definition of wages for FUTA tax purposes. These persons would also be ineligible to claim unemployment benefits with respect to such wages.

* * *

Effective date.—The proposal would be effective with respect to service performed after March 26, 1996.

Conference Committee Report

Senate Amendment.—Same as House.

Conference Agreement.—The conference agreement follows the House bill and the Senate amendment, with the modification that the exclusion would apply for service performed after January 1, 1994.

[¶ 20,075] Act Sec. 5407. Law at ¶ 5468B. CCH Explanation at ¶ 1129.

Welfare Reform—Unemployment Compensation

House Committee Report

[*Work performed in religious schools*]

Exemption of service performed for an elementary or secondary school operated primarily for religious purposes from the federal unemployment tax.—The proposal would exempt from both the FUTA tax and UI benefits work performed in an elementary or secondary school which is operated primarily for religious purposes. This exemption would be available to such schools even though they are not operated,supervised, controlled, or principally supported by a church or convention or association of churches. Persons performing such service would also be ineligible to claim benefits with respect to such wages.

* * *

Effective date.—Date of enactment.

Conference Committee Report

The conference agreement follows the House bill.

[¶ 20,085] Act Sec. 9302. Law at ¶ 5572, 5572A, 5572B, 5572C, 5572D, 5572E, 5572F, 5572G, 5572H, 5572I and 5572J. CCH Explanation at ¶ 1257 and 1258.

Revenue-Increase Provisions—Excise Tax

Senate Committee Report from H.R. 2014

[*Tobacco excise taxes*]

Increase tobacco excise taxes.—

In general.—The bill increases the current excise tax rates on all tobacco products, including cigarettes, cigars, chewing tobacco, snuff, and pipe tobacco, effective October 1, 1997. Floor stocks taxes are imposed on tobacco products at the time of the rate increase (including tobacco products in foreign trade zones).

Specific tax rate increases.—The following table shows the specific tobacco excise tax rates under the bill as of October 1, 1997:

Article	*Tax rate (October 1, 1997)*
Cigars:	
Small cigars	$2.063 per thousand.
Large cigars	23.375% of manufacturer's price, up to $55 per thousand.
Cigarettes:	
Small cigarettes	$22.00 per thousand (44 cents per pack of 20 cigarettes).
Large cigarettes	$46.20 per thousand.
Cigarette papers	$0.0138 per 50 papers.
Cigarette tubes	$0.0275 per 50 tubes.
Chewing tobacco	$0.22 per pound.
Snuff	$0.66 per pound.
Pipe tobacco	$1.2375 per pound.
Roll-your-own tobacco	$0.66 per pound.

The bill also includes expanded compliance measures designed to prevent diversion of non-tax-paid tobacco products nominally destined for export for use within the United States.

Effective date.—The provision is effective on October 1, 1997.

Conference Committee Report

The conference agreement follows the Senate amendment to H.R. 2014, with modifications. First the tax rate on small cigarettes is increased by $5 per thousand (10 cents per pack of 20 cigarettes) and the tax rates on other currently taxed tobacco products are increased proportionately beginning on January 1, 2000. On January 1, 2002, the small cigarette tax rate is increased by an additional $2.50 per thousand (5 cents per pack) with the tax rates on other currently taxed tobacco products also being increased proportionately at that time. Thus, the aggregate tax increase on small cigarettes is 15 cents per pack of 20 cigarettes. The conference agreement imposes tax on "roll-your-own" tobacco at the same rate as pipe tobacco.

Effective date.—The conference agreement is effective on the date of enactment for tobacco products removed after December 31, 1999, and December 31, 2001, respectively. Appropriate floor stocks taxes are imposed on January 1, 2000, and on January 1, 2002.

Committee Reports

Taxpayer Browsing Protection Act

¶ 25,001

Reproduced below in Act section order are the pertinent texts of the controlling Committee Reports that explain the changes enacted by the Taxpayer Browsing Protection Act (P.L. 105-35). The material herein is the official wording of the House Ways and Means Committee Report, No. 105-51, released April 14, 1997.

On July 23, 1997, the bill was brought to the Senate floor and passed unanimously without amendment, bypassing the Senate Finance Committee. Thus, there are no Senate or Conference Committee Reports. Any omission of text is indicated by asterisks (*).

[¶ 25,015] Act Sec. 2. Law at ¶ 5712 and 5712A. CCH Explanation at ¶ 1004.

Prohibition on Browsing

House Committee Report

[*Unauthorized inspection: Criminal penalties*]

Criminal penalties.—The bill creates a new criminal penalty in the Internal Revenue Code. The penalty is imposed for willful inspection (except as authorized by the Code) of any tax return or return information by any Federal employee or IRS contractor. The penalty also applies to willful inspection (except as authorized) by any State employee or other person who acquired the tax return or return information under specific provisions of section 6103. Upon conviction, the penalty is a fine in any amount not exceeding $1,000,[4] or imprisonment of not more than 1 year, or both, together with the costs of prosecution. In addition, upon conviction, an officer or employee of the United States would be dismissed from office or discharged from employment.

The Congress views any unauthorized inspection of return information as a very serious offense; this new criminal penalty reflects that view. The Congress also believes that unauthorized inspection warrants very serious personnel sanctions against IRS employees who engage in unauthorized inspection, and that it is appropriate to fire employees who do this.

* * *

Effective date.—The bill is effective for violations occurring on or after the date of enactment.

[¶ 25,025] Act Sec. 3. Law at ¶ 5719. CCH Explanation at ¶ 1007.

Prohibition on Browsing

House Committee Report

[*Unauthorized inspection: Civil damages*]

Civil damages.—The bill amends the provision providing for civil damages for unauthorized disclosure by also providing for civil damages for unauthorized inspection. Damages are available for unauthorized inspection that occurs either knowingly or by reason of negligence. Accidental or inadvertent inspection that may occur (such as, for example, by making an error in typing in a TIN) would not be subject to damages because it would not meet this standard. The bill also provides that no damages are available to a taxpayer if that taxpayer requested the inspection or disclosure.

The bill also requires that, if any person is criminally charged by indictment or information with inspection or disclosure of a taxpayer's return or return information in violation of section 7213(a) or (b), section 7213A (as added by the bill), or 18 USC section 1030(a)(2)(B), the Secretary notify that taxpayer as soon as practicable of the inspection or disclosure.

Effective date.—The bill is effective for violations occurring on or after the date of enactment.

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[4] Pursuant to 18 U.S.C. sec. 3571 (added by the Sentencing Reform Act of 1984), the amount of the fine is not more than the greater of the amount specified in this new Code section or $100,000.

Appendices: Sample Client Letters

Client letters explaining the ramifications of the tax law changes made by the Taxpayer Protection Act of 1997 are intended for practitioners to help clients understand the recent law changes and the effect on a client's tax, financial, or estate plan. Practitioners may wish to distribute or adapt these letters to give clients a framework for their own customized plan.

The following letters are provided.

Comprehensive Tax Planning

This letter may be sent to clients or prospective clients to inform them in a general way of the impact of the Taxpayer Relief Act of 1997, the probable need for tax and estate planning in light of the Act, and some of the basic strategies and techniques that can be used to help them same taxes. *See Appendix A.*

Investment Planning

This letter may be sent to alert current or prospective clients to the Taxpayer Relief Act of 1997 changes affecting investors, among them the lower capital gains rates, the introduction of the exclusion of $500,000 in gain from the sale of a residence, and the restrictions imposed on certain trading tactics. *See Appendix B.*

IRA Savings Opportunities

This letter may be sent to current and prospective clients who might be eligible for individual retirement arrangements (IRAs). It explains how the new law has expanded IRAs and alerts clients to the potential benefits the new law could provide for them. *See Appendix C.*

Education Tax Strategies

This letter may be sent to clients or prospective clients to alert them to the need for planning in order to capitalize on the savings opportunities, included as part of the Taxpayer Relief Act of 1997, to help finance the cost of higher education. *See Appendix D.*

Estate Planning

This letter may be sent to current or prospective clients to inform them in a general way of their probable need for gift and estate planning and of some of the basic strategies and techniques that can be used to help them save gift or estate taxes, particularly in light of the Taxpayer Relief Act of 1997. *See Appendix E.*

Appendix A

Sample Client Letter: Comprehensive Tax Planning

Dear Client:

The Taxpayer Relief Act of 1997—the first major tax cut legislation in more than 16 years—was passed by Congress by overwhelming majorities as part of its historic Budget Reconciliation package and signed by the President on August 5. This law sets new records not only for the size of the tax cuts it provides, but also for its widespread impact.

Instead of a broad-based tax cut, however, this legislation is selective—making big winners out of many taxpayers but causing others to lose ground. Financial, retirement, estate and business planning are therefore all made more necessary by the new law. Despite $151.6 billion in tax cuts over five years, the new law can mean problems for those caught in the web of over 100 "simplification" provisions, and those who simply fail to recognize how to maximize their benefits under the new law.

A new capital gains rate structure typifies the substantial tax reductions, and added complexity, introduced by the '97 Act. The top capital gains tax rate for individual taxpayers is lowered to 20% from the present 28% maximum rate, for investments held for more than 18 months (12 months if the investment was sold after May 6 but before July 29, 1997), retroactive to any sale made after May 6, 1997. Assets sold on or after July 29 having a holding period of more than a year but less than 18 months will be taxed as "mid-term gain" at the old 28% rate. For assets held more than five years, the new rates are still lower: 18% on assets *purchased* after December 31, 2000 (8% on assets *sold* after December 31, 2000, for those in the 15% tax bracket).

Financial planning and retirement planning assumptions are all affected significantly by this sizable reduction in the capital gains tax rates. Current asset allocations must be reevaluated. And avoiding the rules throughout the Code designed to prevent the conversion of ordinary income into capital gains will take on greater importance.

Rules for a new variety of IRAs offer opportunities but are made more complex. In offering individuals the option of regular IRAs, education IRAs, backloaded "Roth IRA" (formerly called IRA Plus) accounts, IRA withdrawals for first-time homebuyers, as well as changes in income phaseouts and other contribution limits, the '97 Tax Act creates choices which require sometimes complex numbers crunching and financial goal-setting for a new range of taxpayers. The new rules are effective starting in 1998.

The new IRA rules open up the availability of IRAs to many more individuals. A new "Roth IRA" account offers a major new opportunity for tax-free buildup and withdrawal that should prove virtually irresistible for taxpayers with the money to spare (up to $4,000 per year for couples) and no foreseeable need for it. And other changes liberalize the rules for *current* IRAs.

Families who follow the new rules in the '97 Act can receive much-needed help in financing their children's higher education tuition payments. The help comes in the form of tuition tax credits and a new education IRA that would allow taxpayers to make nondeductible annual contributions of up to $500 per child. The earnings build-up would be tax-free and withdrawals would also be tax-free. The education tax incentives will require a reevaluation of how best to save for a college education. Lower capital gains tax, expanded IRA opportunity, qualified plan loans, the "kiddie" tax, tuition savings plans, student loans and excluded scholarships all figure into the mix.

Starting in 1998, the '97 Tax Act increases the present $600,000 effective unified estate and gift tax exemption to $1 million, in a series of steps between 1998 and 2006. The Act also provides a $1.3 million exclusion (including the unified credit) for family-owned farms and businesses, but careful planning is required because there are complex requirements on which business, estates and beneficiaries qualify for the exclusion.

But the rise in the unified credit does not reduce the need for planning. Due to the effects of inflation, the Act's increases still will not exempt nearly as many individuals for federal estate tax consideration as when the $600,000 exemption was first put into place. If the unified credit were adjusted for just 3% annual inflation since 1987, when it was last raised, it would now be equal to $830,000, and by the time the new phase-in is complete in 2006, it would be worth $1.08 million.

We would be pleased to assist you in separating the opportunities from the pitfalls in this lengthy and complex tax legislation.

Sincerely yours,

Appendix B

Sample Client Letter: Investment Planning

Dear Client:

Congress and President Clinton have finally reached agreement and the Taxpayer Relief Act of 1997 has become law. As you no doubt have heard, the new law contains some important relief for investors, in particular significantly reduced--and more complex--capital gains rates. However, there are also some important provisions directed against techniques whereby an investor economically locks in his gains but defers recognition of the gain for tax purposes, chiefly "selling short against the box." Thus the new law presents both opportunities and potential pitfalls for investors.

For sales before May 7, 1997, gain on sales of capital assets you held for more than a year received advantageous treatment in that it was taxed at a maximum rate of 28%, no matter how high the rate you must pay on your other income. Suppose, for example, that in 1996 you had $10,000 in long-term capital gains. That $10,000 was subject to a maximum tax of $2,800, even if your other income was high enough to put you in the 31%, 36% or even 39.6% bracket. Thus, the 28% maximum rate would have saved you $300, $800, or $1,160, respectively.

The new law has both lowered the rates and introduced a new level of complexity. Depending on the holding period, time of disposition, type of assets, and regular income tax bracket, there are now nine possible rates for capital gains. The top capital gains rate is lowered to 20% from the former 28% maximum rate, but only for investments held for more than 18 months (12 months if the investment was sold after May 6 but before July 29, 1997). For taxpayers in the 15% regular tax bracket for 1997 ($41,200 taxable income for joint filers and $24,650 for singles), the maximum net capital gains rate is an even lower 10%. These rate cuts are effective retroactive to any sale made after May 6, 1997.

The new rates will be still lower for assets held more than five years: 18% on assets purchased after the year 2000, and for those in the 15% regular income tax bracket, 8% on assets sold after the year 2000.

As a result of the new, longer 18-month holding period to qualify for the lower 20% rate, a new category—mid-term gain—has been introduced. After July 28, 1997, assets held over 12 months but not over 18 months will be taxed at the old 28% rate as mid-term gain (whereas if they were sold after May 6 but before July 29, they would get the benefit of the lower 20% rate).

Collectibles are still taxed at the old 28% rate, and gain attributable to depreciation deductions for real estate must be recaptured at 25%—still a benefit, however, considering that a portion of pre-May 7, 1997 gain had to be recaptured at regular rates. Gain from qualified small business stock remains limited to the existing 50% exclusion, for an effective 14% rate, although a new rollover provision is directed at such investments.

This increase in the difference between capital gains rates and the rates for other income provides a huge incentive to invest in capital assets. Individuals who are heavily invested in assets that yield ordinary income, such as bonds, high-dividend yield stocks or even deferred gain from variable annuities or 401(k) plans may want to consider changing their investment strategy. Those who have engaged in frequent trading may also wish to modify their tactics since the holding period for the favorable rates has been lengthened to 18 months.

If you're confused by any of these new rules, please give us a call and let us explain how they affect you. We can explain how you can best take advantage of the lower rates; we can also explain the treatment of capital gains in connection with such items as mutual funds, installment sales, the minimum tax, sales of depreciated business real estate, collectibles such as art, jewelry and coins, and the special 50% exclusion for investing in small companies for at least five years.

On the down side, the new law disallows traditional gain deferral techniques, such as selling short against the box, that have been widely used to lock in gain economically while not causing the gain to be recognized for tax purposes. Anyone involved in the financial markets should discuss the new rules with us.

One of the biggest breaks in the new tax law replaces the two special rules for deferring gain on the sale of your home (the two-year rollover and the age 55 exclusion). The new rule lets you pay no tax on up to $500,000 of gain on the sale of your home, ($250,000 for single taxpayers). This tax break is retroactive to May 7, 1997, and is reusable every two years, although complicated rules on five-year ownership, "unforeseen events," and marital status also apply. Taxpayers with sales or contracts signed after May 6, 1997, but before August 5, 1997, have the option of using the old rollover deferral or the age-55-or-over exemption instead. These provisions may make your home your most tax-favored investment. We would be happy to explain how the fine points of this new tax break apply to your personal situation.

In this letter, we can only summarize briefly the highlights of the new legislation as it affects investors. We hope that this summary gives you an indication of some of the tax benefits to be realized and pitfalls to be avoided through thoughtful tax planning. We stand ready to assist you in any tax planning necessary for you to maximize your tax benefits under the new law.

Sincerely yours,

Appendix C

Sample Client Letter: IRA Savings Opportunities

Dear Client:

The Taxpayer Relief Act of 1997—the major piece of tax-cutting legislation that was just signed into law on August 5th—makes significant changes in the rules for individual retirement arrangements (IRAs) that will make them available to many more middle and upper-middle class taxpayers than ever before. The new law also broadens the range of available IRAs in a way that will make them an attractive savings vehicle that could potentially become an important part of your financial plans.

The Act introduced a new kind of IRA, called the "Roth IRA," which will first become available in 1998. Although contributions to these new IRAs are not deductible, they provide a key benefit: qualified distributions from them *aren't includable in gross income or subject to the additional 10% tax on early withdrawals*. To be qualified, a distribution must be made after the five-year period beginning with the first tax year you make a contribution to a Roth IRA. It must also be (1) made on or after the date you reach age 59 1/2; (2) made to a beneficiary or your estate on or after your death; (3) attributable to your being disabled; *or* (4) a qualifying special purpose distribution, including a distribution made for up to $10,000 of first-time homebuyer expenses. (The provision excepting first-time homebuyer expenses from the early withdrawal tax applies to other IRAs, as well.)

Eligibility for these new accounts phases out at fairly high income levels: between $95,000 and $110,000 for singles, and $150,000 and $160,000 for joint filers. Further, you can make contributions to a Roth IRA even after you reach age 70 1/2. And if you already have an IRA, you may be able to roll it over or convert it into a Roth IRA. You can only do this, however, if your income is less than $100,000.

The Act also establishes new education IRAs. These IRAs are exclusively for the purpose of paying qualified higher education expenses—post-secondary tuition, fees, books, supplies, equipment, and certain room and board expenses. You can make nondeductible annual contributions of up to $500 per beneficiary. The earnings build-up is tax free and withdrawals are also tax free. The earnings portion of distributions not used for higher education expenses will be income to the beneficiary and be subject to the additional 10-percent tax on early withdrawals. Income phaseouts for eligibility begin at $150,000 for joint filers and at $95,000 for singles.

The new law also liberalizes the rules governing traditional, deductible IRAs. For example, the income range in which deductible contributions are phased out will increase in steps, eventually making them available to many more people. Beginning very gradually in 1998, with much bigger jumps beginning in 2003, the phase-out ranges will eventually reach $80,000 to $100,000 for joint filers in 2007, and $50,000 to $60,000 for singles in 2005. IRA contributions may therefore become deductible in those years even if your income currently exceeds the phase-out threshold. In another significant change, for tax years beginning in 1998, you won't be considered an active participant in an employer-sponsored plan merely

because your spouse is an active participant, so you can make a deductible contribution to an IRA, even if your spouse participates in an employer-sponsored retirement plan, if your adjusted gross income does not exceed certain levels.

If you are interested in investing in hard assets, the new law creates more exceptions to the general prohibition against investing IRA assets in collectibles. Beginning in 1998, in addition to the currently permissible investment in certain gold, silver, and state-issued coins, IRA assets may also be invested in certain platinum coins and qualifying gold, silver, platinum, or palladium bullion.

The elimination of penalties for excess retirement accumulations and excess distributions will permit planning without the need to consider these penalties.

We would be happy to explain the advantages and disadvantages of the full spectrum of IRAs which will soon become available, as well as the eligibility requirements for them. In addition, we can help you evaluate the potential benefits of making IRAs a part—or a bigger part—of your financial future. Since most of the changes take effect beginning in 1998, it is not too early to start planning now. Just let us know if we can be of help.

Sincerely yours,

Appendix D

Sample Client Letter: Education Tax Strategies

Dear Client:

More than a quarter of the $151.6 billion tax-cut that was just signed into law has been earmarked for tax breaks for education. The education provisions of the new law—the Taxpayer Relief Act of 1997—can mean thousands of dollars in tax savings not only for the taxpayer with children in college or grad school, but also for those who pursue further education and training to help them at work. Here are some examples:

Education tax credits. These consist of two separate credits—the "HOPE" scholarship credit of up to $1,500 per year per student for tuition and fees for each of the first two years of college, and the Lifetime Learning credit that is worth up to $1,000 ($2,000 beginning in 2003) per year for an unlimited number of years for college juniors, seniors, graduate students or working Americans pursuing job skill training. Employees will benefit from the new Lifetime Learning credit since it includes tuition and related expenses in connection with any course of instruction at an eligible educational institution to acquire or improve job skills. The benefits of the credits begin to get "phased out" for couples with more than $80,000 in adjusted gross income ($40,000 for singles). The credits apply to qualified tuition and related expenses of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer for whom a personal exemption can be claimed. Some tricky rules on course-load levels and covered expenses apply.

Extension of employer-provided educational assistance exclusion. The '97 Tax Act has extended the employee exclusion of up to $5,250 of employer-provided education assistance to courses beginning before June 1, 2000. While not applying to graduate-level courses, excludable education allowances from an employer need not be related to the employee's current job.

Education IRA. A new education IRA allows taxpayers to open up an IRA specifically for a child's education and make annual contributions of up to $500 per child. Although these contributions won't be deductible from your return against other income, the earnings build-up will be tax-free and withdrawals to pay for qualified higher education expenses will also be tax-free. Fortunately, income phase-outs are quite high, beginning at adjusted gross income amounts of $150,000 for couples and at $95,000 for single filers.

Deduction for interest on education loans. After an initial phase-in period (beginning with $1,000 in 1998), student loan interest of up to $2,500 a year beginning in 2001 will be deductible whether or not a taxpayer itemizes deductions. The deduction will be available for the first five years of the loan with an income phase-out beginning at $60,000 of AGI for couples ($40,000 for singles).

Other beneficial education incentives in the new tax legislation include penalty-free withdrawals from retirement IRAs for higher education expenses and expanded tax-free

treatment for state prepaid tuition plans. Undoubtedly, some of these provisions will be more important to you than others, depending upon personal circumstances. If you would like to explore how the new legislation can work for you and have us fully evaluate your situation, please do not hesitate to call.

Sincerely yours,

Appendix E

Sample Client Letter: Estate Planning

Dear Client:

There has always been a widespread myth that estate planning is only for the super-rich, and that misconception has probably been reinforced by the well-publicized news about the rise in the estate tax exemption in the new tax-cut that was just signed into law. On the contrary, with the new tax law, taxpayers have even more reason to begin estate planning or update their existing plans.

The reality is that federal estate tax will take a sizable bite out of any estate above $625,000 in 1998. So it is important to realize not only how much you're really worth now but how much your current assets may eventually grow. Taking into account your home, life insurance, retirement plans and IRAs, CDs, money market funds, stocks, bonds, real estate and other investments, inheritances you may receive, jewelry and personal belongings, your assets can easily exceed the federal estate tax threshold. The amount of property that is effectively exempted from estate and gift taxes will increase over the next nine years from the current amount of $600,000 to $1 million in 2006. This means that your plan will require careful review to ensure that your desires are accomplished during the phase-in period.

Planning, however, can help you minimize estate tax liability and possibly escape it altogether. The first step is to inventory your assets to determine your potential liability. Then, we can tailor a plan to suit your particular situation.

There are many tools at our disposal. A lifetime giving program is one of the best ways to transfer wealth to your children tax free. You can transfer as much as $10,000 each year ($20,000 if your spouse joins in making the gift) to as many people as you want without any gift or estate tax liability. Under the Taxpayer Relief Act of 1997, the annual gift tax exclusion amount is indexed for inflation after 1998. Larger gifts that you make during life (and anything earned on those gifts) won't be subject to estate tax, although gifts in excess of the annual gift tax exclusion may push your estate into a higher bracket by using up your unified estate and gift tax credit.

Spouses can make tax-free transfers to one another to ensure that each spouse is able to use his or her maximum unified credit, which together can protect up to $1.25 million in 1998 with properly drafted wills, thanks to the new law. Special kinds of trusts can be set up to ensure that spouses and children are both taken care of with the least estate tax liability. These strategies also help ensure that any estate taxes that are owed won't be due until after the death of the second spouse.

There are special estate-tax strategies for business owners that can help keep a family business going after the founder's death. The new Act provides an elective exclusion for family-owned business up to $1.3 million, including the amount effectively exempted by the unified credit. There are, however, complicated rules on which businesses and estates qualify for the increased exclusion, and careful planning is necessary to meet the requirements.

There also are new opportunities for the charitable-minded to benefit both family members and a charity while cutting estate tax and saving income tax currently. You also might be able to benefit from a life insurance trust, which can keep insurance proceeds free of estate tax.

Of course, a key element of your estate plan is your will, which lets you control and direct the disposition of your estate. Without one, state "intestacy" laws will determine who gets what without regard to your wishes or your survivors' needs. Even if you already have a will, changes in the new tax law may requiring updating it to take maximum advantage of all the expanded benefits.

These are just a few of the many estate planning techniques that may be available to you. If you have any questions about developing an estate plan or revising an existing one, we are available to provide the assistance you need.

Sincerely yours,

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